STREAMLINED SALES AND USE TAX AGREEMENT: STATES' EFFORTS TO FACILITATE SALES TAX COLLECTION FROM REMOTE VENDORS

HEARING

BEFORE THE

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COMMERCIAL AND ADMINISTRATIVE LAW

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STREAMLINED SALES AND USE TAX AGREEMENT: STATES' EFFORTS TO FACILITATE SALES TAX COLLECTION FROM REMOTE VENDORS

WEDNESDAY, OCTOBER 1, 2003

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:02 p.m., in Room 2141, Rayburn House Office Building, Hon. Chris Cannon (Chair of the Subcommittee) presiding.

Mr. CANNON. Good afternoon, ladies and gentlemen. This hearing of the Subcommittee on Commercial and Administrative Law will now come to order.

We consider today the efforts made by the States to achieve a uniform sales and use tax regime. I am pleased to convene this hearing following the recent passage of the Internet Tax Nondiscrimination Act, H.R. 49. As you may know, H.R. 49 ensures the tax-free access to the Internet for all Americans, and I encourage my colleagues here and in the other body to move quickly to pass the companion bill prior to the expiration of the existing moratorium on November 1. That is just the other body, not our colleagues. We have done our work.

The concepts we will discuss today have long been linked to the Internet access issue. During consideration of H.R. 49, I stated my intention to convene a separate hearing on this issue to afford it careful attention. This hearing is the result of my commitment, and I thank my colleagues with whom I have worked. I would also add that my Subcommittee may hold additional hearings on this subject in the future.

The Streamlined Sales and Use Tax Agreement, or the SSTA, is the result of considerable effort by States and organizations. In November 2002, 31 States ratified the SSTA following substantial review and discussion by members of the project. Following ratification of the SSTA, member States began to adopt tax legislation in compliance with the terms of the agreement.

The SSTA marks a significant departure from the sales and use tax system now in place in the United States. Under the Commerce Clause of the U.S. Constitution, Congress has sole authority to regulate commerce among the States. The Commerce Clause prevents the States from interfering with or unduly burdening interstate commerce through the use of its taxing authority.

Particularly relevant to our discussion are two Supreme Court cases, *National Bellas Hess* v. *Department of Revenue of Illinois*, and *Quill Corporation* v. *North Dakota*. These rulings prohibit States from compelling a remote seller lacking a physical presence in the State to collect or remit taxes from sales made to citizens within that State's boundaries. The Court added that it was up to Congress to determine whether, when, and to what extent States may burden interstate mail order concerns with a duty to collect use taxes.

That set of buzzers was irrelevant. I think we are recessing across the street.

Given these rulings, the SSTA remains voluntary. However, the project seeks Congressional approval of the agreement which would authorize the States to compel out-of-State merchants to collect sales and use taxes on all sales to customers in their respective States. I add that, while legislation has been introduced to authorize this agreement, that bill, while likely to be referred to this Subcommittee, is not before us today for consideration. Rather, what we first address are the concepts contained in the agreement before considering legislative action.

In light of the duties bestowed upon Congress by the U.S. Constitution, we must consider this agreement carefully to ensure that its provisions would not unduly burden interstate commerce. We must not take our responsibility lightly. For these reasons, I look forward to the testimony of our highly informed panel, each of whom is an expert in this complex subject. Some, but not all, Members have followed the intricacies of this project closely and the details are extremely important here. I, therefore, encourage my colleagues to ask questions of the witnesses in order to inform the debate.

I now yield to Mr. Watt, the Ranking Member of the Subcommittee, for an opening statement.

Mr. WATT. Thank you, Mr. Chairman, and I thank the Chairman for convening the hearing. We have had hearings about this subject before, but all too often, they have been to vex about the problem that exists rather than to focus on a particular kind of solution to the problem. I think this is the first step in the process of focusing on efforts to address a problem that has been around for a long time, going back even before the Internet to catalog sales and other remote sales.

State governments rely on the sales and use taxes for approximately 32 percent of their total tax revenue, and it is estimated that $55 billion of that tax revenue over the next 10 years could be adversely affected if we don't solve this problem. That is a lot of money for the States.

So a lot of people have been working on trying to find a solution that we could all buy into. I want to applaud the work of the Advisory Commission that has been meeting and applaud the work of my colleague, Mr. Delahunt, and others who have been working on this bill, H.R. 1552—no, that is not the right bill, H.R. 3184. H.R. 1552 is the one we already passed.

I am looking forward to the testimony of the witnesses. I think that there is a bipartisan interest in trying to reach a solution to this problem and I think there will be a great effort on all parts to continue to make this a bipartisan effort to find a solution rather than a partisan effort to keep a solution from being found, and that is what I have found is the time and circumstance in which Congress can typically do its best work.

So, witnesses, you are laying the groundwork for that to happen with today's hearing and I appreciate your being here. I appreciate the Chairman convening the hearing for that purpose. I yield back.

Mr. CANNON. I thank the gentleman from North Carolina, the Ranking Member of the Committee.

I also want to acknowledge the presence of Mr. Delahunt from Massachusetts and Mr. Coble from North Carolina. We may have with us a little later the gentleman from Alabama, Mr. Bachus. Although Mr. Bachus is not a Member of the Subcommittee, he is a Member of the full Judiciary Committee, and in accordance with Subcommittee practice, the chair will exercise its discretion in allowing Mr. Bachus to utilize any time for questioning which is yielded to him by a Member of the Subcommittee and we will welcome him if and when he arrives.

Before I begin with witness introductions, the record of this hearing will remain open for five legislative days, until close of business on Tuesday, October 7. During that time, interested parties may submit statements for inclusion in the hearing record.

Our first witness is the distinguished Governor of Colorado, Bill Owens. In keeping with the Ranking Member's concern about bipartisanism, I would like to point out that I am deeply jealous of the Governor's record in life. He was a page in this institution for Jim Wright in 1967 and is probably one of the few people on the face of the earth who can navigate this building, having learned it within a year or two after its construction.

Governor Owens is Colorado's 40th governor, and in 2002, he was reelected with the greatest majority in the State's history. The Governor holds an impressive record on many issues, including tax relief for Colorado families, another factor of which I am jealous, I might say, since Utah has a much higher per family tax rate than Colorado does. Also, for improving the quality of education and transportation improvements. He pushed through the largest tax relief package in the history of Colorado, earning him accolades from the Wall Street Journal, the Economist magazine, and many other organizations.

Under Governor Owens' leadership, Colorado has fully funded public education 3 years in a row. He instituted sweeping school reforms in his State by creating an education accountability system, which has been praised as among the best in the nation. Keeping his commitment to transform Colorado's transportation system, he adopted innovative policies to accelerate long-neglected mass transit policies.

Prior to his current post, Governor Owens was known as one of Colorado's most effective policy makers while serving in the State's House and Senate and also as Colorado Treasurer. He holds a master's degree in public administration from the Lyndon B. Johnson School of Public Affairs at the University of Texas.

Governor, we recognize your work and attention to this issue and are honored to have you here today. We look forward to your valuable input. Why don't we go ahead with your testimony and then we will introduce each witness as we get to them. Thank you, Governor.

STATEMENT OF THE HONORABLE BILL OWENS, GOVERNOR, STATE OF COLORADO

Governor OWENS. It is an honor to be in the Rayburn Building, and as I was telling the chair, I first came here in 1967 when Jim Wright was chairman of Public Works and am honored to still call our former Speaker a close friend.

Thank you for the opportunity to appear before you today on a critically important issue facing America's economy, State governments, and American taxpayers. Today, leaders in government at the State and Federal level are truly facing a profound decision. Should we reject a Supreme Court decision that allows many online mail and telephone retail purchases to be exempt from sales tax? Should we enact a national sales tax regime that would impose taxes on those purchases?

The proposed Simplified Sales Tax Act, SSTA, is far from the fine-tuning of America's approach to retail taxation that its proponents would have us believe. Indeed, I believe that this plan would fundamentally alter the retail landscape in America and change the nature of digital commerce. I offer for the record a copy of a paper published by the Center for the New American Century, which I am the chair. The paper is titled, "Nine Problems With Taxing the Internet." It was published earlier this year.

[The prepared statement of the Honorable Bill Owens follows:]

PREPARED STATEMENT OF THE HONORABLE BILL OWENS

CNAC

CENTER FOR THE NEW AMERICAN CENTURY

Nine Problems with Taxing the Internet

Questions Governors and Legislators Must Consider

By Bill Owens
Governor of Colorado

Introduction

Governors and legislators across the country are being asked to endorse a multi-state compact to impose taxes on Internet-based sales. Because no sales tax can be collected on catalog or on-line transactions that occur with out-of-state merchants, many officials here in Colorado and across the nation are making the case for a new, national taxing regime to capture those dollars from consumers.

Called the Streamlined Sales Tax Project, or SSTP, the new system would be formed by a compact among the states that is authorized by Congress. Its advocates say the new system will harness technology to create a "burdenless" sales tax collection system. The project, which would ostensibly "simplify" the myriad sales tax systems used by states and localities, aims to achieve two goals:

- to maintain the stream of sales tax revenues that are being "lost" as online sales become more prevalent; and
- to reduce a perceived competitive disadvantage between traditional "brick and mortar" retailers who must collect sales taxes on all purchases and remote retailers who must collect taxes only in limited circumstances.

While some states have already embraced the SSTP, much of the drafting of this sweeping change in America's tax system SSTP occurred out of public view. In order to let some sun shine in on this tax proposal, I asked policy-makers in my state to examine nine questions. The answers, provided below, raised significant concerns. Some of its policies are

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Bill Owens, Chairman of the Center for the New American Century, is serving his second term as Colorado's 40th Governor.

Nine Questions to Consider . . .

Is the SSTP revenue neutral?
No. The SSTP's goal of $440 billion in "new revenue" over 10 years would negate one third of President Bush's federal income tax cut of 2001.

Will the SSTP simplify tax compliance for America's merchants, as its proponents suggest?
No. SSTP would preserve many of the current complexities of calculating and collecting sales taxes and add new ones. A merchant would be subject to up to 7,500 different tax rates on transactions with consumers.

Does the SSTP pose threats to consumer privacy?
Yes. The SSTP proposes one or more third-party tax collection agents, who will gain automatic access to confidential information about individual consumers and what they purchase.

Will the SSTP require your state and its local jurisdictions to forfeit sovereignty over tax policy in your state?
Yes. The SSTP creates the U.N. of state tax policy. It requires each state to submit its sales tax system to oversight of a "governing board."

Is the SSTP consistent with the Constitutional doctrine of federalism?
No. The SSTP would allow participating states to foist their tax and regulatory burdens upon out-of-state businesses and citizens.

Will the SSTP reduce tax policy competition between states?
Yes. The SSTP rewards the least competitive states by allowing them to "dumb down" the tax code.

Will the SSTP impede the success of the technology revolution?
Yes. Attaching tax burdens to each online transaction will inhibit people's access to and use of Internet content and stifle technological innovation.

Will the SSTP hurt certain citizens more than others?
Yes. New on-line transaction taxes will disproportionately punish rural, handicapped or even elderly buyers who cannot easily substitute on-line transactions with traditional purchases at brick and mortar retailers.

Will the SSTP create equity between brick and mortar and on-line retailers?
No. SSTP might create equal tax rates for on-line and brick and mortar transactions, but creates new inequities in compliance costs and in the availability of certain benefits.

I believe wrong for Colorado. In other cases, SSTP policies or proposed implementation of the project just create entirely too much ambiguity or leave too much to chance when it comes to the taxes paid by Americans.

I fear the SSTP, while designed with some good intentions, could have serious and long-lasting negative economic effects for states that embrace and implement it. From a policy standpoint, the SSTP approaches the perceived problems with an unhealthy bent toward big government. The answers to these nine questions make a compelling case for the need for a public, national discussion before moving forward with the SSTP.

I. Is the SSTP revenue neutral?

No. SSTP will increase the tax burden on most American consumers. SSTP's supporters tout a study of sales and use taxes authored by two professors at the University of Tennessee that concludes state and local governments could collect an additional $440 billion in sales taxes from the American people over the next 10 years by expanding sales tax collection to all Internet commerce. Some experts believe the $440 billion figure overstates the windfall. Whereas the University of Tennessee professors count on $45 billion in new revenue by 2006, for example, a study commissioned by the Direct Marketing Association reports a figure of $3.2 billion over the same time period. Either way, SSTP is a tax increase. But if we accept supporters' estimate of $440 billion, SSTP could negate one-third of President Bush's $1.3 trillion federal income tax cut of 2001.

Because SSTP takes a broad view of taxable goods, additional hidden tax increases could lurk in the esoteric details of the SSTP. States that currently exempt certain goods from taxation could be forced to extend sales taxes to currently untaxed products, as an example. And all caps that limit sales tax liabilities would be eliminated. So while a farmer in North Carolina who purchases a piece of farm equipment is currently capped at $80 in total sales taxes, SSTP would fully tax the entire value of his purchase.

Minnesota provides another telling example of how taxes will subtly increase as states adopt SSTP uniform provisions. Prior to adopting the SSTP, Minnesota imposed sales taxes only upon the price of each product purchased from a vendor with nexus in the state. The SSTP defines "sales price" more broadly to include not only the price of the product, but also charges for shipping, handling and postage. Because Minnesota adopted the SSTP, not only do the people of Minnesota pay new sales taxes on purchases from out-of-state vendors, but they also pay higher taxes on purchases from in-state vendors.

If the prospect of unsuspecting voters learning of tax hikes isn't cause enough for fear, consider this: Some states could actually *lose* revenues under SSTP. Those states that do not currently reimburse in-state merchants for their costs of collection will be mandated to pay a uniform reimbursement rate for all merchants, whether in-state or out-of-state. The adoption of SSTP will, therefore, affect each state differently, and will add a new dimension of uncertainty to budget planning in the coming years.

How Much New Revenue Would New On-line Sales Taxes Really Generate?

Estimates of potential new government revenues vary widely

DMA estimate: Peter A. Johnson, Senior Economist, The Direct Marketing Association (March 2003). SSTP estimate: Donald Bruce and William F. Fox, Center for Business and Economic Research, University of Tennessee (September 2001).

II. Will the SSTP simplify tax compliance for America's merchants, as its proponents suggest?

No. The goal of simplifying tax compliance for businesses is laudable. As Governor, I frequently hear concerns voiced by retailers, particularly small businesses, regarding the complexity and cost of complying with the current tax system.

But SSTP would actually magnify these current problems. Most notably, SSTP foists national sales tax collection obligations upon each merchant in America while preserving for each local government in the country its own distinct tax rate. That means a merchant will have to calculate up to 7,500 different tax rates on transactions to consumers. Merchants will even be responsible for determining each customer's nine-digit zip code, since five-digit zip codes cross local jurisdictional boundaries.

These realities confound the initial promises made by SSTP sponsors. At the inception of the SSTP process, they promised that their efforts would produce a "burdenless" sales tax collection system so streamlined that it would be suitable for the Internet. They examined two solutions to promote simplicity and uniformity.

First was to create one sales tax rate per state. Participants in the National Tax Association's Communications and Electronic Commerce Tax Project (consisting of major state and local government associations) unanimously agreed in their final report, issued September 7, 1999 (pp. ii & 3): "There should be one rate per state which would apply to all commerce involving goods or services that are taxable in that state."

But drafters of the SSTP ran into a political roadblock: efforts to achieve simplicity and uniformity were undercut by efforts to preserve some semblance of local control. They were therefore forced to reject the idea of one-rate per state and allow municipalities to establish varying rates.

The second goal for easing the burden of tax compliance involved the development of new technology. SSTP sponsors promised to develop and demonstrate a "third-party" tax collection software package that could be seamlessly integrated into the business systems of each merchant in America and that would perform all tax calculation, collection and remittance functions.

I enthusiastically support the efforts of the SSTP to develop technology to ease the burden of tax compliance. Whether the SSTP moves forward or not, this is a worthwhile goal.

But even if the ideal system is invented, adopted and implemented across the nation (and there are significant doubts that such a system can be successfully deployed in the near future), SSTP would still result in new burdens and threats to America's merchants. An Internet or catalogue merchant that opts to perform tax collection functions itself will be subject to 46 different audits by 45 different states and the District of Columbia each year to ensure the merchant is properly collecting and remitting its taxes.

Even in states that opt not to participate in the SSTP, merchants will be at risk if its supporters succeed in convincing Congress to authorize the compact. A merchant in Colorado who sells goods across state lines will be audited for compliance not only with his own state's tax code but also for compliance with the SSTP. If an auditor concludes that the merchant under-collected a state or local government's due share, the merchant will have two options – pay the difference or pay a lawyer to litigate.

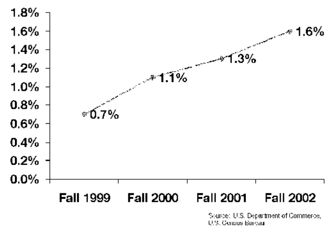
SSTP participants started out with the worthy goal of promoting simplicity in tax compliance. But the only true way to ensure simplicity – a uniform tax rate for each participating state – was rejected. And the promise of new technology has instead acted as cover for a multitude of new complexities. Thus, one of the best arguments in the SSTP's favor rings hollow: instead of simplification, SSTP is an exercise in tax compliance complexification.

III. Does the SSTP pose threats to consumer privacy?

Yes. Consumer privacy has become a major issue in Colorado and across the nation in recent years. In Colorado, our Legislature passed and I signed legislation to crack down on e-mail spam and to create a no-call list for telemarketers. In 1999, one of the state's vendors began collecting data regarding Colorado consumers from our automobile license database. The public outcry was understandable. This is why ensuring consumer privacy is an indispensable component of any national sales tax collection effort.

The SSTP's authorization of one or more third-party tax collection agents that integrate their tax collection software into the mainframes of each merchant

E-Commerce as a Percent of Total Sales



creates substantial questions about the protection of consumer privacy. At the time of a transaction, the software would calculate the tax due and remit the tax to the destination state and locality, keeping a portion of the tax as its fee. In the process, however, the collection agent would gain access to information about individual consumers and what they purchase.

What protections are there for the consumers? The SSTP is internally inconsistent on this issue. On the one hand, it instructs third-party tax collectors to "respect" the "precept of anonymity" in their tax collection functions. On the other hand, the SSTP provides that "[e]ach member state's laws and regulations regarding the collection, use and maintenance of confidential taxpayer information remain fully applicable and binding" in the implementation of the SSTP.

Thus, the disparate and often confusing laws of 50 different states and the District of Columbia supersede any SSTP "precept," and, since nobody has any experience with the new national sales tax collection scheme, it's anybody's guess what protections a consumer in my state can count on when her favorite vendor in a participating state gets audited or subpoenaed in a tax dispute. Will her personal information and purchase choices be protected under Colorado law, where she lives, or under the law of the state where her vendor operates? SSTP has not answered this fundamental question.

IV. Will SSTP require your state and its local jurisdictions to forfeit sovereignty over tax policy in your state?

Yes. Check the SSTP statute.[1] Oversight and implementation of a significant portion of your state's tax policy would be ceded to and dictated by a board of unelected and unaccountable out-of-state tax bureaucrats. SSTP essentially creates the U.N. of state tax policy.

To resolve disputes, SSTP requires each state to submit its sales tax system to oversight of a "governing board" comprised of four representatives from each participating state, with each state getting one vote on the board. This governing board will be vested with administrative, legislative and judicial powers over each participating state's tax policy. It can amend the SSTP with 60 days notice upon a three-quarters vote of its members, thereby altering each state's tax laws.

Worst of all, this governing board will interpret the SSTP and resolve disputes brought to it like a court of law. It even can sanction participating states it deems not "substantially compliant." (What "substantially compliant" means remains a mystery. The SSTP's governing board will define it on a case-by-case basis.)

V. Is the SSTP consistent with the Constitutional doctrine of federalism?

No. SSTP would allow participating states to reach across state lines and foist their tax and regulatory burdens upon out-of-state businesses and citizens conducting business on the Internet. The goal of SSTP proponents is to get a number of states to pass SSTP and then seek Congressional authorization to force merchants – including those that operate in states choosing not to adopt the SSTP – to collect and remit sales taxes in compliance with the laws and regulations and audits of the adopting states. Businesses, in other words, would be subject to the SSTP's scheme even if their home state democratically chooses not to join the uniform tax regime. This implicates profound practical and theoretical federalism concerns.

For example, a state that was unable to foster a significant information technology industry in the 1990s might adopt SSTP in an effort to force the many software and online content providers of California's Silicon Valley to become their tax collectors of choice, even if California receives nothing in return from businesses in that state.

But SSTP's threat to state and local control extends beyond the theoretical. Many states, Colorado included, have constitutional or statutory limitations on tax increases or revenue collections. Adopting SSTP in Colorado would therefore require a vote of the people. And what if voters in a local jurisdiction vote down the tax change? How will states reconcile voter inspired referenda and initiatives with an SSTP that values national uniformity and limits individuality?

In my home state of Colorado, and in most other states, citizens pride themselves on local control. Many of our counties and cities have obtained "home rule" status, giving them significant constitutional autonomy in their taxing decisions. While certain items are subject to local sales tax in one Colorado city, therefore, they might be exempt in another. Even if Colorado's state legislature agrees to accept SSTP in concept, therefore, compliance with this new, national tax regime would be extremely difficult.

VI. Will the SSTP reduce tax policy competition between states?

Yes. The SSTP rewards the least competitive states by allowing them to "dumb down" the tax code, resulting in a less favorable technology business environment across the country. By nationalizing a significant portion of the tax code historically reserved to the states, the SSTP effectively undermines the notion of states as "laboratories of democracy." As Governor, I've always embraced the notion of constructive competition between the states. Competition spawns innovation and creativity, and we learn from the successes and mistakes of other states.

The SSTP, however, rewards the least competitive states. It hypothetically allows 10 participating states to piggy-back on the economic investments of 40 other (non-participating) states. It attempts to coerce all states into following minority policy – a virtual "tax cartel." But allowing non-competitive states to "dumb down" the tax code will ultimately hurt all states.

VII. Will the SSTP impede the success of the technology revolution?

Yes. Attaching tax burdens to each online transaction will dampen enthusiasm for Internet usage and stifle technological innovation. Some people will inevitably log off rather than fill out the requisite tax form to purchase music or read an online book. Indeed, studies show that a significant number of online shoppers would not participate in electronic commerce if taxes are imposed. According to Prof. Austan Goolsbee's 1999 study, the extension of existing sales taxes to Internet purchases could reduce the number of online buyers by as much as 24 percent.

That on-line transaction taxes would impede utilization of the Internet is cause enough for concern. But even more troubling is that the proponents of a new national sales tax on the Internet are busily working to craft a policy for imposing state and local sales taxes on what they view to be "digital goods." SSTP participants seem to be moving toward a policy that equates online content with tangible goods. The proposed SSTP law already defines "tangible personal property" to include software delivered electronically and uploaded on one's computer.

Clearly, the SSTP's bias is toward what is best for government, not necessarily what's best for consumers, taxpayers or the economy. In the view of SSTP's advocates, tax-free Internet transactions jeopardize the growth rate of government revenues. But why not instead (or at least in addition) look at the situation through the lens of commerce and economic development? The growth of the digital economy, and the family-sustaining jobs spawned by it, could clearly be placed in jeopardy by a system that expands taxes on their entrepreneurs.

VIII. Will the SSTP hurt certain citizens more than others?

Yes. New on-line transaction taxes will disproportionately punish rural, disabled or even elderly buyers who cannot easily substitute on-line transactions with traditional purchases at brick-and-mortar retailers.

The Internet facilitates commerce in places and between parties unimaginable just 10 years ago. Rural communities and transactions involving disabled citizens are just two examples of beneficiaries of Internet transactions. A farmer in western Iowa hundreds of miles removed from any major metropolis can log on and purchase music, clothes, or even farm supplies and equipment via the web. (He saves money on certain transactions in which taxes are not collected, but some if not all of these savings are typically cancelled out by delivery costs.)

By taxing all on-line transactions, individuals who cannot easily substitute on-line transactions with traditional purchases will be hurt the most. The SSTP will therefore have the effect of widening the so-called "digital divide." Urban and suburban dwellers will substitute more expensive on-line transactions with trips to the nearby mall. Rural dwellers and others who cannot easily substitute one transaction for another will face the greatest burden.

IX. Will the SSTP really promote equity between brick-and-mortar and on-line retailers?

No. One of the most compelling arguments I hear on behalf of the SSTP is the case for equity: why should no tax be collected on transactions with out-of-state merchants while brick-and-mortar transactions are taxed?

But if equity is truly the ultimate objective, other variables need to be considered, too. What about compliance costs? If SSTP moves forward, on-line merchants would be forced to calculate and comply with literally thousands of different tax rates across the country. These enormous compliance costs would put on-line merchants at a competitive disadvantage vis-à-vis brick-and-mortar retailers.

Likewise, on-line merchants are not eligible for the many benefits governments sometimes offer traditional retailers. Many brick-and-mortar retailers take advantage of enterprise zones, tax breaks or various direct or indirect government subsidies.

The rhetorically strong argument for "equity," therefore, falls short when other variables are considered.

Conclusion

Transforming the way that state and local governments levy taxes on consumer purchases is one of the central public-policy issues facing Governors and State Legislatures. If successful, the effort to tax all remote purchases will affect every state, county and municipality that levies sales taxes. It will affect virtually every American consumer who makes a purchase by mail, over the phone or online.

Simply put, the headlong rush to accomplish this sea change in American tax policy, often without a detailed public debate and outside the glare of media and taxpayer scrutiny, must be slowed. Significant questions – including the nine asked here – must be faced, discussed and adequately answered in each state.

The growth and expansion of the digital economy, and the innovations and consumer conveniences that have come with it, are transforming and improving lives in America and around the globe in the 21st Century. Companies that were little more than a dream just a few years ago today employ thousands of our fellow Americans – and generate tax dollars for our states. Our goal must be to ensure that government takes no steps that will needlessly stem this growth or unfairly penalize online entrepreneurs.

How we answer the nine questions about taxing the Internet will shape our economic future. We must be well informed, and we must choose wisely.

[1] See, for example, the "Streamlined Sales and Use Tax Agreement," Page 43, Line 28. "If a member state is found to be out of compliance with the Agreement, the governing board may consider sanctions against the state."

Governor OWENS. Rather than discuss those nine points, I will group them into three central questions that policy makers and, I believe, taxpayers should consider. First, is this a new tax? Second, will the expanded sales tax be fair to all retailers and all consumers? And third, what will be the economic effect of this new tax on the emerging digital economy?

The answer to the first question is simple and straightforward. Is this a new tax? Absolutely. The backers of the Internet tax assert that it will bring perhaps $50 billion, perhaps as many as $400 billion into government coffers in the next decade. That money comes from Americans who make online and other remote purchases, money that consumers otherwise wouldn't pay to government. That is what much of the debate is about, is, in fact, increasing revenues for State and local governments across Colorado, or across the United States.

When the government requires American consumers to pay more in sales tax, their sales tax has gone up. That is, I believe, the way that most consumers will view the added dollars on their purchase. Again, that is what most of the legitimate debate is about. State governments, by and large, feel that they are not getting this revenue and they want the revenue and they want to get increased revenue.

If the advocates are correct and the Internet tax will generate billions of dollars in new revenue, I believe it would negate a substantial portion of the tax relief that this Congress and earlier Congresses have provided to the American people.

The second question we must ask is whether this new tax regime is fair. Is it fair to States? Is it fair to consumers? Is it fair to retailers? One key contention of those on the other side of this issue is that it is free money for the States with no strings, no burdens, and no challenges. But it has been my experience that when something sounds too good to be true, sometimes it is.

This proposal could wipe out existing State tax exemptions for certain goods or services, or caps that States have on the amount of sales tax paid on items. It could also override State decisions on the amount of reimbursement provided to retailers, thus costing retailers or States monies.

I believe that this proposal is also an attack on federalism. It would cede significant portions of the oversight and implementation of a significant portion of State tax policy. It would cede this authority to a board of unelected, out-of-State members of the sales tax administrative bureaucracy. The governing board would be vested with legislative, administrative, and judicial powers.

This plan also, I don't believe, is fair to consumers. Sales taxes are, after all, the most regressive taxes. Expanding them will disproportionately affect the poor and middle-class consumers. It is not fair to consumers in rural areas, for whom the Internet is truly a portal to a wider selection of goods and services. It is not fair to disabled Americans who benefit from having Internet shopping just a mouse click away.

Internet advocates have also ignored the threat to consumer privacy. Government auditors will surely want to ensure that the Internet tax dollars are being properly remitted. Such an audit would necessarily include an examination of what was purchased, exactly where that person lives, and how much was paid and how much tax was remitted.

And then, finally, I think the tax is unfair to retailers, but not the way in which the tax supporters claim it is unfair. Indeed, it is the online retailer who is the loser under this proposal to tax the Internet. While a brick-and-mortar retailer must collect the tax at only one single rate, depending upon where that brick-and-mortar retailer is located, we would be requiring online retailers to, in fact, pay taxes to up to 45 States plus the District of Columbia and put together the administrative overhead to make sure that works.

The final question we have to ask about the Internet tax centers on its economic effect. I really believe that attaching tax burdens to each online transaction will dampen enthusiasm for Internet usage. It will stifle technological innovation. And I believe at this point in time, with Internet sales making up less than 1 percent of total retail sales, that the last thing we want to do is to put burdens on this particular form of retail sales, because I think it will diminish this particular niche at exactly the time when we need to be encouraging it.

For these reasons and many others, I hope that you will reject proposals to allow the States to tax the Internet, and again, Mr. Chairman and Members of the Committee, it is my honor to be here with you this afternoon. Thank you.

Mr. CANNON. Thank you, Governor. We appreciate those comments and assure you that we will have questions when we get to that point.

I should have pointed out that we have a set of lights on the table. At 4 minutes, a yellow light will go on. At 5 minutes, a red light will go on. We don't expect you to quickly terminate your statement. This is not a debate where we cut things off. But recognize that and we have enough time to go over a bit.

Mr. CANNON. Our next witness is Ms. Maureen Riehl, who is Vice President, State and Government Relations Counsel, for the National Retail Federation. The NRF is the world's largest retail association, affiliated with all 50 State retail associations and over 35 national retail trade associations in the United States.

Ms. Riehl serves as the national spokesperson on State affairs for the retail industry. She is responsible for the development of the NRF's national strategy and policy implementation for issues affecting retailers.

Ms. Riehl is a hands-on expert on the Streamlined Sales Tax Agreement. She works directly with the implementing States and with its supporting organizations toward developing the streamlined system.

A graduate of Michigan State University and Thomas Cooley Law School, Ms. Riehl is actively involved in many State policy groups. Ms. Riehl, your expertise with respect to this project will greatly inform the debate and we appreciate your testimony.

STATEMENT OF MAUREEN B. RIEHL, VICE PRESIDENT, STATE AND GOVERNMENT RELATIONS COUNSEL, NATIONAL RETAIL FEDERATION

Ms. RIEHL. Thank you, Chairman Cannon and Mr. Watt and Members of the Committee. I am very honored to be here today to speak on behalf of the National Retail Federation as well as other businesses that have helped in the development of the Streamlined Sales Tax Agreement.

Concisely, I will say that I have five points to bring to the attention of the Committee today: One, why retailers care; two, that the Streamlined Sales Tax Agreement in fact is a careful balance of both sovereignty and simplification; third, it provides certainty where retailers currently do not have certainty; fourth, it provides for equal collection responsibility for all sellers; and finally, to touch on an issue that it is time to legislate, not litigate.

Why retailers care about Streamlined Sales Tax Agreement? First of all, contrary to the Governor, this is not a new tax. Use tax is a consumption tax that is owed by all purchasers made from an out-of-State sale. Retailers assume that sales taxes are here and they are going to remain intact in the States in which they currently exist, but that system needs modernizing.

The Streamlined Sales Tax Agreement provides an opportunity for retailers to drastically reduce the cost of collection and it provides certainty for retailers where currently we do not have any. And finally, it is important to distinguish that the streamlined agreement and any future activity by Congress is distinctly separate from the Internet Tax Freedom Act or the moratorium.

Second issue, this is a careful balance of both sovereignty and simplification. I will be the first to say, as a 4-year participant in the development of the agreement, that it is not perfect. Nonetheless, we have taken strides to take the input of business, to filter that through the political realities that exist in the 46 jurisdictions that have sales tax, and develop something that is both feasible but does strike a careful balance.

The States still maintain their sovereign rights to decide three very important issues, what they tax, at what rate, and the legislatures will always have the ability to choose whether to be involved in this project or not involved with this project.

SSTA is very pro-retail. Retailers will now have the benefit of common definitions, centralized administration of the sales tax, limits on audits, which are an enormous cost burden to retailers, and we can have simplicity down to one rate per zip code.

Another issue, certainty. This is the biggest issue for retailers. Simplification in the retailers' mind is defined as certainty. The States are going to be responsible for the development of a database that will actually identify for every retailer that is involved in the project a list of what items are taxable and at what rate. That is an enormous improvement over what we have now, which is basically a lot of guess work.

A fourth issue, equal collection responsibility for sellers. This has long been the mantra of the National Retail Federation because it is our belief that as long as the sales and use tax are maintained as a source of revenue in the States, that the most appropriate way to collect that tax is at point of sale. Traditional sellers do that today. It is believed that with a simplified system, the burden will be removed for remote sellers to such an extent that it would be easy for them to do the collection, as well. Likewise, remote sellers under Congressional legislation that I will talk about in a moment will also be compensated for any burdens that they might still residually have as part of their collection responsibilities.

The final message I want to bring to you all today and why it is appropriate that Congress is now hearing this is because it is critical that businesses have an opportunity to work to legislate rather than litigate. States are going to get the money from retailers one way or another. It is either going to be through cooperation, which I think is an example of the Streamlined Sales Tax Agreement. If not by cooperation, then it will happen by force. States now—Illinois's Attorney General is a good example—are already bringing suit against upwards of 70 different remote sellers for questionable nexus to the State of Illinois.

We believe that trend will continue unless there is some way in which businesses can get some certainty through a voluntary agreement with the States. The voluntary agreement is not the way to get all retailers to participate. Congress is the only body that can act to transition a voluntary agreement into a mandatory agreement.

The timing is right. As I have indicated, States are poised to relitigate *Quill*. That does not provide businesses, however, with the protections that bills like H.R. 3184, introduced last week by Congressmen Istook and Delahunt—thank you very much—insofar that decisions by a court do not provide some key benefits to businesses, not just retail, but businesses.

As we shift from the State focus in the development of the agreement to Congress, I would have you think of these few items. States have laid the groundwork for a fundamental workable system that will continue to achieve greater simplifications over time. Congress, however, is the only assurance that American business has that a mandatory collection system will be fair, equitable, remain simple, and provide benefits to business, and I will articulate them.

Only Congress can provide the solution. Only Congress can provide for a small business exception of $5 million in gross remote annual sales. Only Congress will provide the right of appeal to Federal court for any taxpayer or business that is not dealt with fairly by the governing board. Only Congress will provide for vendor compensation for remote sellers that are currently not obligated to collect. Only Congress can provide a firewall, ensuring that there will not be the use of tax information for business activity taxes or other business taxes that are exposures for business.

Congress can act this year and it is encouraged by the retail community that they do so. We believe that the States have done the hard work. We remain committed to this process and, indeed, will remain committed to working with Congress, as well, as this education process proceeds.

Thank you very much for the opportunity to share some comments on behalf of the Retail Federation.

Mr. CANNON. Thank you, Ms. Riehl. We appreciate those comments.

[The prepared statement of Ms. Riehl follows:]

Prepared Statement of Maureen B. Riehl

Good afternoon Chairman Cannon, Ranking Member Watt and members of the Committee. My name is Maureen Riehl. I am the Vice President, State and Government Relations Counsel for the National Retail Federation (NRF), in Washington, D.C. I am here to comment on NRF's support for the Streamlined Sales Tax Agreement and to urge action by Congress in 2003 to authorize the states to require sales tax collection by all sellers.

The National Retail Federation is the world's largest retail trade association with membership that comprises all retail formats and channels of distribution including department stores, specialty stores, discount stores, catalogue merchants, Internet vendors and independent stores. NRF members represent an industry that encompasses more than 1.4 million U.S. retail establishments, employs more than 20 million people—about 1 in 5 American workers—and registered 2002 sales of $3.6 trillion. NRF's international members operate stores in more than 50 nations. In its role as the retail industry's umbrella group, NRF also represents over 100 state, national and international retail trade associations.

HISTORY: THE RETAIL PERSPECTIVE.

According to the decisions in two relevant United States Supreme Court decisions, Bellas Hess and Quill, the court ruled that state and local sales tax systems were complicated and placed an undue burden on interstate commerce. Because of this burden, remote, out-of-state sellers have been excused from collection of sales or use tax on sales made to remote buyers except in instances where the seller has nexus with the state of the buyer. The advent of the Internet and growth of e-commerce retail sales established a situation where traditional "Main Street" sellers, with no e-commerce or remote sales activity, were both losing sales to competitors on the Internet, while also suffering a non-negotiable price disadvantage of an average of 6% (the average state sales tax rate) for

selling the same goods. Considering that most retailer profit margins are on the scale of 3–4%, a non-negotiable price disadvantage of 6% on top of the cost of the goods being sold is clearly a significant discrimination against main street sellers. "Non-negotiable price" (i.e. the sales tax rate mandated for collection by retail on taxable items at storefront) is a relevant distinction, as the shipping, handling and related delivery costs to a remote seller with no nexus in a state are ALL negotiable fees for completing a transaction with a remote buyer.

NRF agrees that main street sellers benefit from enhanced services from state and local government, and thus should be obligated to help support those services through the collection of sales tax. It is also true that services provided for by state and local government such as roads, fire and police are used every day by out-of-state sellers to facilitate the delivery and in-route protection of merchandise to in-state buyers.

Sales tax is a consumption tax. Customers that live in a state with sales and use taxes are individually responsible for payment of that tax to their home state. Legally, the in-state merchant collects the sales tax for the customer; typically, the out-of-state merchant without nexus to the buyer's state does not collect use tax for the customer. NRF believes that the appropriate place to collect a consumption tax—owed by customers—is at the point-of-sale. NRF's interest is in ensuring that the cost of collection for retailers be eliminated altogether, or minimized, and that the obligation to collect must apply equitably across all channels of sale. Likewise, for remote sellers that currently have no legal obligation to collect tax for their remote buyers, the remote seller's costs of collection should be paid for by the states.

The Streamlined Sales Tax Agreement (SSTA) ratified by 31 states in November of 2002 was a culmination of over four years of intense review and negotiation among business groups—such as NRF and several of its members—state tax experts, and state and local elected officials focused on simplifying state sales and use tax laws. Each of the simplifications detailed in the 76-page SSTA benefit retailers in some fashion. In the 20 states that have adopted a majority of the SSTA since July 2003 and any other state that may later do so, in-state retailers and voluntary remote sellers will be able to avail themselves of a simpler, less costly system for sales tax collection beginning as soon as 2004. SSTA represents the necessary first step for equal collection responsibility for all sellers.

VOLUNTARY V. MANDATORY SYSTEM.

The SSTA is a voluntary agreement; voluntary to the states (a state must pass legislation or adopt rules to be in compliance with the SSTA), and voluntary to remote sellers without nexus in a state. The benefit to a remote seller that volunteers under the SSTA is that the incentives—both financial and the audit hold-harmless provisions—are attractive and significant for those remote sellers that may have either questionable nexus with a state(s), or in instances where the SSTA provisions compliment the remote seller's business development plan.

A voluntary system is a good start, but it does not take care of the problem of winners and losers in the retail world. The problem can only be fixed with a mandatory system, one that does not discriminate based on the way in which goods are bought or sold, and one that mandates collection by all sellers in states that are in compliance with the SSTA. In order for the voluntary SSTA to transition to a mandatory system in the near future, Congress must act.

WHY DO RETAILERS CARE? ASSUMPTIONS AND REALITIES.

NRF involvement in the development of SSTA was predicated on the following:

1) Sales tax is here to stay. Of the tax revenue sources used in states—property, income and/or sales—a consumption tax such as the sales tax has been found in numerous polls and public opinion surveys to be the least offensive to taxpayers, as taxpayers can "choose" to pay the tax based on how much they consume;
2) Pre-SSTA, state and local sales tax systems were complicated and costly for retailers to administer;
3) Pre-SSTA, retailers have no certainty. 7,600 different taxing jurisdictions have varying rates, varying definitions and varying rules, often forcing retailers to guess about taxability;
4) This is not a new tax, and it does not address access to the Internet. The Internet Tax Freedom Act of 2001 (ITFA) does not apply to sales tax collection responsibilities. ITFA does not address or fix the problem.

With over 30 major administrative and political changes, the SSTA provides a baseline framework for a simpler system of sales and use tax collection. SSTA is not perfect—but it is a vast improvement over the systems in place today. Work is ongoing in the area of more definitions, more simplifications, more CERTAINTY for retailers. Mechanisms exist within the SSTA for states to form a Governing Board to act as the primary decision-making body for future iterations of the SSTA that will ensure that simplification efforts will continue.

BENEFITS OF SSTA TO RETAILERS.

Of the numerous benefits to retail articulated in the SSTA, a few of the most notable are:

1) Centralized administration at the state level of all sales and use taxes;
2) Uniform exemption certificates with a shift in the burden to the state for authentication;
3) Limitations on audits and a hold-harmless provision for mistakes made by retailers using a state authorized system or software program;
4) Common definitions;
5) Limited rates.

SSTA establishes a road map for retailers to know what is taxable, and at what rate—thus providing retailers with certainty in administration, while preserving the sovereign rights of states on political issues of taxability

THE ROLE OF CONGRESS.

Last week, Congressmen Istook and Delahunt introduced HR 3184, the Simplified Sales and Use Tax Act of 2003 (SSUTA). Senators Enzi and Dorgan are soon expected to introduce companion legislation in the Senate.

SSUTA encompasses the necessary action needed by Congress to transition the voluntary SSTA into a mandatory system for all retailers selling within their own state or selling into simplification states. SSUTA was developed by NRF and other business groups, in concert with state and local governments. SSUTA has the full endorsement of the NRF.

Timing is critical. Action is needed by Congress THIS YEAR. Action by Congress in 2003 will both bless the SSTA as passed by 20 states thus far, as well as encourage the other sales tax states to adopt SSTA.

SUMMATION.

NRF supports the Streamlined Sales Tax Agreement. As retail assumes that the sales tax is both a significant, viable and the least offensive source of state and local government revenue, the rules for sales and use tax collectors should be the same. The most feasible collector of this consumption tax is the retailer, who with the help of modern technology, will now know with certainty what is taxed, and at what rate, regardless of which venue is used to complete the sale. Likewise, federal legislation, HR 3184, to transition the SSTA into a mandatory system is supported by NRF, and needed in order for retail to share equal collection responsibilities, and for retail venues to be subject to the same tax rules.

Mr. Chairman, I appreciate the invitation to come and address you and the committee members on the merits the sales tax simplification effort overall, and to specifically endorse action by Congress to modernize state sales tax systems.

Thank you for your kind attention.

Mr. CANNON. Let me acknowledge the presence of Mr. Carter from Texas. Thank you for being here, Judge. And also Mr. Bachus from Alabama. Mr. Bachus, I think that we have communicated on rules and so we will try and have enough time so that someone can yield time to you to ask questions, if you would like, when that time comes.

Mr. BACHUS. I don't actually anticipate any questions.

Mr. CANNON. Okay, great. Thank you.

Our next witness is George Isaacson, tax counsel to the Direct Marketing Association and senior partner of the law firm of Brann and Isaacson in Lewiston, Maine. Mr. Isaacson has served as tax counsel to the DMA for over 15 years. He has represented the association in the filing of amicus curiae briefs in State and Federal courts throughout the country, including the United States Supreme Court. Another expert on the SSTA, he has represented the DMA in negotiations with State governors on the streamlining effort.

A frequent speaker on taxation of interstate transactions and taxation of electronic commerce, he is also outside counsel to L.L. Bean, Inc. Mr. Isaacson teaches constitutional law at Bowdoin College, where he earned his undergraduate degree. He received his law degree from the University of Pennsylvania.

Mr. Isaacson, we look forward to your testimony and thank you for sharing your expertise with us today.

STATEMENT OF GEORGE S. ISAACSON, TAX COUNSEL, DIRECT MARKETING ASSOCIATION

Mr. ISAACSON. Thank you, Mr. Chairman and Members of the Committee. I appreciate the opportunity to appear before you today and discuss the issues that are pending and that could conceivably change constitutional standards that have governed the scope of State taxing powers for more than 100 years.

Governor Owens spoke eloquently to issues concerning consumer privacy, the effect that federally mandated tax collection of the Internet could have on matters of economic impact on the country, but what I would like to speak to more specifically are questions that relate to the actual features of the SSTA and the process that was associated with it.

All the serious analysts and academics that have looked at the American sales and use tax system have stated that the core problem associated with any effort to expand the scope of State use tax jurisdiction is the fact that there exist thousands of tax jurisdictions in this country. There is State, county, municipal, sewer district, school district, library district, sports stadium district, all of which have the power to impose taxes, and the consensus of all those analysts has been that the only reasonable way to discuss an expansion of State tax authority would be by a reduction in the number of such tax jurisdictions and that would have to be the cornerstone of State tax reform.

The problem with the SSTA is it involves no reduction in such number of jurisdictions. When the Supreme Court looked at this issue back in 1967 in the Bellas Hess case which you referred to, Chairman, there were over 3,000 tax jurisdictions. When the Supreme Court looked at the issue again in 1992 in the *Quill* case, there were over 6,000 such jurisdictions. And today, the number is approaching 8,000 jurisdictions. This problem worsens and the SSTA does not address it.

Now, prior government and industry studies on the issue, including the National Tax Association Study, which involved both industry and government associations, including the National Conference of Mayors, the National Conference of State Legislatures, the National Governors Association, along with industry, as well as the Advisory Commission on Electronic Commerce, all agreed that the problem was the number of tax jurisdictions, and the majority report of the Advisory Commission and the report of the National Tax Association study all proposed that there should be only one tax rate per State if the tax authority of the States is going to be expanded across their existing State borders.

The SSTP, when it considered this proposal, decided that it was simply too controversial and bypassed it and instead proposed that the silver bullet for dealing with the number of tax jurisdictions would be to come up with tax compliance software that would cut through the problem. And in that regard, the SSTP commissioned a pilot study in 2000, the intention of which was to develop prototype software and examine its applicability. This initial project involved only four States and only several retailers, and the report of the SSTP's pilot project, which was issued in March of this last year, concluded that there is no existing software that can address the problem and that we are still a long ways from being able to achieve it.

Now, the problem primarily concerns an issue of integration and compatibility, because you need to integrate the software systems of thousands of retailers, of 40 States, of dozens of service providers, and the SSTP study was incapable of achieving that result.

So the States come before Congress today asking for a mandatory tax collection without having a road-tested, demonstratively proven system of compliance software to deal with these new and increasing burdens. The absence of compatibility software is a key shortfall in the SSTP project. It constitutes a promise which has not been met, a promise which was part of the system supposedly from its origin.

Many of the provisions of the SSTA involve vague and speculative approaches to resolving problems of merchant collection of taxes. For example, the system contains no specifics regarding vendor compensation. Proponents of the Streamlined Sales Tax Agreement agreed to conduct a joint industry-government study of what the cost of collection would be, and that study was commissioned in 2001, but here we are 2 years later and we still do not have a report regarding what the actual costs of collection will be. It is simply premature to come before Congress and ask Congress to bless a system which has neither the compliance software nor accurate figures regarding what the cost of compliance would be. It is important to go back to the drawing boards to obtain that information.

Now, the comment has been made that there are 20 States that have already passed conforming legislation, but a very disturbing fact has been that the conformity legislation is itself non-conforming. Many of the States that have passed legislation have passed legislation addressing only parts of the SSTA, not its entirety. An example, Texas, for example, has decided not to enact the important sourcing provisions of the SSTA. The same thing is true of the State of Washington. None of the States that have passed so-called conformity legislation have enacted any provisions that deal with customer confidentiality or deal with vendor compliance, vendor compensation. Consequently, instead of having conformity legislation, what we have is a series of acts being passed by State legislatures that are partial and incomplete.

Perhaps even more disturbing is the fact that a number of States are engaging in end-runs around the legislation. For example, what they are doing is changing the name of a tax from being a sales tax to being an excise tax or a special use tax, and thereby not having it be applicable. Or alternatively, what they are doing is having tax increases by passing new local use taxes or enacting taxes on shipping and handling charges where they didn't previously exist.

The fact of the matter is that we neither have an SSTA agreement which has addressed the important issues of tax complexity, nor do we have conforming legislation that matches even the weakened version of uniformity that the SST project has passed. What is important is to go back to the drawing board and do it right. This system is simply not ready for prime time.

Mr. CANNON. Thank you, Mr. Isaacson. We appreciate your comments.

[The prepared statement of Mr. Isaacson follows:]

PREPARED STATEMENT OF GEORGE S. ISAACSON

Mr. Chairman, Members of the Committee, on behalf of the Direct Marketing Association ("DMA") and its membership, I want to thank you for the opportunity to testify on this important issue. The DMA is the largest trade association for businesses interested in direct marketing to consumers and businesses via catalogs and the Internet. Founded in 1917, it today has over 4,700 members companies in the United States and 53 foreign countries.

I realize that many state tax officials hail the Streamlined Sales and Use Tax Agreement ("SSTA") as an epochal event in sales and use tax reform. The reality, however, bears little similarity to the hyperbole. The truth is that the Streamlined Sales Tax Project ("SSTP" or "Project") has woefully failed to fulfill its original goal of simplifying and harmonizing the existing morass of state and local sales and use tax laws. Indeed, the representatives of the states participating in the Project have, at every critical juncture, turned away from real and substantive tax reform in order to cling to the many diverse and unique features of their individual state tax systems. It is this disparity in state and local sales taxes that makes the existing tax regime so ill-suited to interstate commerce. The Streamlined Sales and Use Tax Agreement, in its current form, falls far short of its professed objective of simplifying state taxes and, to the contrary, in many respects worsens, and further complicates, the Acrazy quilt" of differing state and local sales and use tax laws.

It is important to note that the original stated purpose of the SSTP was to establish a purely *voluntary* system of simplified sales and use tax collection by catalog companies and Internet merchants. It is, therefore, especially disturbing that despite the Project's failure to meet its own goals, the proponents of the SSTP nonetheless now come to Congress seeking federal legislation that would eliminate longstanding constitutional protections for interstate commerce and convert the SSTA into a *mandatory* use tax collection system for out-of-state merchants.

The jurisdiction-expanding legislation sought by state tax administrators would give states the unprecedented power to export their diverse tax systems beyond their own state borders, thereby imposing an extraordinary level of complexity on interstate marketers and consumers. The timing of this ill-conceived proposal could not be worse. New tax burdens on Internet retailers will suppress the growth of e-commerce when the dot-com economy is still struggling to rebound from its dramatic decline. Also, such legislation would give an advantage to foreign companies—especially electronic commerce vendors of digital products who are located far beyond state tax jurisdiction—at the expense of American businesses. The inevitable effect would be the loss of American jobs in the e-commerce sector and a drag on this country's economic recovery.

In addition to its adverse economic impact, the Agreement would implement a new government-sanctioned system in which massive amounts of information concerning the details of consumer transactions would be gathered, retained, and disseminated among not only government agencies but also to private companies that are designated as "services providers" under the SSTA. The Agreement contains no safeguards against disclosure or misuse of such confidential information. Congress should not approve a new tax system that would imperil the privacy of millions of American consumers.

In short, the SSTA provides little simplification of the current tax system; it creates numerous new burdens on business and consumers; and it endangers the privacy of millions of Americans. Congress should reject this misguided call to abandon constitutional protections and expand state tax powers. Instead, Congress should encourage the states to return to the drawing board and address the critical areas of tax simplification and fairness to retailers and consumers that the Project chose to bypass in its effort to achieve consensus among the participating states.

My testimony will highlight some of the most glaring shortcomings and striking adverse consequences of the Streamlined Sales and Use Tax Agreement, including:

- The failure to adopt the fundamental principle of "one rate per state" for all commerce, which would have eliminated the problem of merchant compliance with literally thousands of local tax jurisdictions;
- The failure to establish uniformity of definitions with respect to taxable and exempt products;
- The failure to reduce, in any meaningful way, the burdens of tax collection, reporting, remittance and audits for interstate marketers;
- The SSTP's blind-faith in yet-to-be-developed tax compliance software as the "silver bullet" that will solve the overwhelmingly complex tax compliance problems presented by the multi-state sales and use tax system described in the Agreement;
- The failure to consider the Agreement's impact on consumers ordering products by mail and paying for their purchases by check;
- The failure to guarantee fundamental fairness with respect to vendor liability and vendor compensation;
- The failure to provide an effective and enforceable mechanism to assure continuing compliance with the Agreement by member states;
- The failure to provide oversight of the member states by an independent entity or tribunal;
- The failure to provide even basic privacy protections for the personal and financial information of millions of American consumers;
- Imposition of new taxes on consumers in connection with member states' adoption of so-called SSTA conformity legislation; and
- Coupled with jurisdiction-expanding legislation, the imposition of enormous new burdens upon interstate and electronic commerce, at a time when the nation's economy, and particularly the e-commerce industry, is struggling to make a recovery.

I. STATE TAX ADMINISTRATORS ARE ASKING CONGRESS FOR AN UNPRECEDENTED EXPANSION OF STATE TAXING AUTHORITY.

The question of whether states should be permitted to impose their state and local tax requirements on businesses operating outside their borders goes to the heart of the founding principles of our Constitution. Such time-honored legal protections should not lightly be set aside. The Constitution's Commerce Clause has consistently been interpreted as barring states from imposing tax obligations on companies and individuals located beyond a state's borders and who have no physical presence in the taxing state. Indeed, the Constitutional Convention of 1787 was initially called to address the problem of individual state legislatures imposing taxes and duties on trade with other states, a practice which was pushing the young country into a depression. The Commerce Clause was intended by the Framers to prevent state and local tax laws from hindering and suppressing interstate commerce. It has worked remarkably well. More than 200 years before the establishment of the European Union, the Framers created a common market on this continent through the Commerce Clause, and it powered the greatest economic engine the world has ever known.

There can be no question, as even the leaders of the SSTP have acknowledged, that the existing patchwork of different state and local sales and use tax laws creates an inordinate complexity that is excessively burdensome on interstate businesses. There are literally thousands of different sales and use tax jurisdictions in the United States. Of the 30,000 state and local jurisdictions with authority to impose sales and use taxes, more than 7,500 have adopted this kind of tax, and the number grows every year. These thousands of different jurisdictions generate an enormous variety of tax rates, taxable and exempt products, excluded transactions, filing requirements, audit arrangements and appeal procedures. Moreover, these rates and exemptions are frequently changed by the governing jurisdictions, so they are literally a moving target in terms of vendor compliance. Indeed, it was this dizzying complexity that prompted the Supreme Court, in its 1992 decision in *Quill Corp.* v. *North Dakota*, to reaffirm its long-standing position that the Commerce Clause bars states from imposing such taxation requirements on interstate commerce.

Congress should exercise great caution before removing over 200 years of constitutional protection of America's open market place. Such an encroachment of state tax sovereignty into the realm of interstate commerce is without precedent. Congress should be insistent on setting the bar of state tax reform very high before it endorses an expansion state tax jurisdiction. Certainly, the SSTA does not achieve such high-bar tax reform; to the contrary, the SSTP participants repeatedly chose to lower their standards and reject fundamental reforms.

II. THE SSTP FAILED TO MEET ITS OWN STANDARDS FOR A STREAMLINED SALES AND USE TAX SYSTEM.

When it was organized in 2000, the Streamlined Sales Tax Project presented itself as a bold initiative by state legislators and tax administrators to simplify, harmonize and modernize state and local sales and use tax laws. The stated goal of the SSTP was to create a new "streamlined" sales and use tax system for the 21st Century, with substantial uniformity among state sales and use tax regimes. Historically, the sales tax has always had a decidedly local flavor, with varying rates and requirements among state and local tax jurisdictions. Unfortunately, when the Project representatives were confronted with the difficult task of surrendering the unique features of their state and local tax systems, they repeatedly retreated from original proposals for real tax reform and consistently rejected, or diluted, provisions that would have produced true uniformity among the states.

At its outset, the SSTP program was intended to be a voluntary program from the perspective of both tax officials and those businesses subject to sales and use tax obligations. In theory, the participating states undertook the task of modernizing and harmonizing their tax systems as a matter of good public policy, not as a prelude to expanded tax jurisdiction. In this regard, the Project expressed its hope to achieve a degree of simplification and standardization that would encourage retailers with no legal obligation to collect sales and use tax outside of their home states to register nonetheless in all participating states.

The shared understanding of all concerned, tax administrators and retailers alike, was that the existing system was one of daunting complexity, and that true simplification would require radical reform. In this regard, the SSTP organizers took note of the fact that their new initiative was preceded by two separate joint government/industry projects whose mandate was to examine the measures necessary to simplify the existing sales and use tax system and make it more accommodating to the needs of electronic commerce. They were: (1) the National Tax Association Communications and Electronic Commerce Tax Project ("E-Commerce Tax Project"), and (2) the Congressionally-established Advisory Commission on Electronic Commerce ("Advisory Commission"). Both groups were composed of representatives of state government and industry. Moreover, the need for major revisions to state sales and use tax codes was beyond dispute. For example, the Final Report of the Advisory Commission stated:

> [C]learly the need for substantial simplification is necessary in this emerging digital economy. In the course of the Commission's examination of the impact of e-commerce on sales and use tax collections, there was general agreement among the Commissioners that the current sales and use tax system is complex and burdensome. Most, if not all, of the Commissioners expressed the view that fundamental uniformity and simplification of the existing system are essential.

In order to remedy the complexities of the existing system, leaders of the SSTP committed themselves to creating a new, simplified and uniform sales and use tax system, and they accordingly adopted high standards from the outset. The SSTP committed itself to achieving:

- Greatly simplified tax rates and tax bases;
- Uniform and simplified definitions for taxable and exempt products;
- The incorporation of new technologies to automate the tax collection and reporting process;
- Simplified administration, including centralized registration, simplified returns remittances, and audit procedures;
- Fair treatment of all retailers, and a sharing of the burdens of tax compliance between states and retailers; and
- The highest degree of security and privacy for consumer transactions.

The SSTP undertook to pursue these goals ostensibly with industry input, although without industry participation in decision-making. The DMA contributed suggestions from the outset, setting forth in a letter to Project leaders in August 2000 a comprehensive list of reform proposals. (A copy of the letter, dated August 4, 2000, accompanies my written testimony.) The fate of the DMA's proposals in the SSTP process is telling, both with respect to the weight industry positions actually carried with the Project leaders and the states' failure in achieving their original goals. Of more than 30 specific reform proposals offered by the DMA, the Agreement approved by the states in November 2002 fully adopted only two (centralized registration and uniform bad debt provisions).

During the course of drafting the Agreement and deliberating on its provisions, when the member state representatives had the opportunity to tackle the major problems of tax complexity (*e.g.*, multiplicity of tax jurisdictions and rates), they elected instead to avoid controversy and yield to any member state that raised an objection to a reform proposal. The result is an Agreement that contains only minor, and in many instances cosmetic, tax reform measures. The Agreement leaves intact the myriad of peculiarities and prerogatives of individual state and local tax jurisdictions which characterizes the current system. In particular, the SSTP: (1) rejected real rate simplification by affirmatively maintaining all 7,500 local taxing jurisdictions; (2) failed to identify functional tax compliance software, because none exists; (3) abandoned its commitment to consumer privacy; (4) failed to reduce tax compliance and audit burdens on sellers by rejecting centralized administration; (5) failed to perform a promised cost-of-collection study to determined the costs to retailers of complying with the SSTA; and (6) so diluted the SSTA's state law compliance standard that it destroyed any possibility of even modest uniformity among member states. As a result, rather than a uniform system, the SSTA perpetuates, and in many respects aggravates, a taxation system of tremendous complexity.

A. The SSTP Rejected Real Rate Simplification By Summarily Dismissing The Principle of "One Rate Per State," The Most Fundamental Reform Necessary For a Simplified Sales/Use Tax System.

Rate simplification through the reduction in the number of taxing jurisdictions in the United States is at the core of required reforms. The Supreme Court in *Quill* (and in prior decisions), as well as both joint government-industry groups that preceded the SSTP, recognized that the complexity of the existing system derives, in large measure, from the staggering number of local taxing jurisdictions. Indeed, the United States is the only economically developed country in the world with a system of sub-state transaction taxes. Without a substantial reduction in the number of tax jurisdictions, a catalog or Internet retailer subject to the SSTA would be required to stay abreast of, and collect and remit taxes for, not only its home state (and any other states where it has a physical presence), as current law requires, but every one of the more than 7,500 state and local taxing jurisdictions.

Local sales taxes appear in the form of municipal taxes, county taxes, school district taxes, transportation district taxes, sanitation district taxes, sports arena district taxes, etc. These local taxes often are piled one atop another, resulting in a state tax and several local jurisdiction taxes applying to the sale of a single product. Elimination of multiple local tax rates could be achieved by permitting only one tax rate for all transactions in a state (the so-called "one rate per state" proposal). That rate would be a single, statewide combined rate covering the state tax and a uniform local tax rate (which could be divided among as many local government entities as the state chose). The fundamental necessity of "one rate per state" reform was recognized by both previous simplification projects. Participants from both industry and government groups, including representatives of the National Governors Association, the National Conference of State Legislatures, and the U.S. Conference of Mayors, *unanimously* agreed in the Final Report of the NTA's E-Commerce Project that there should be only one rate per state for all commerce. A majority of the Advisory Commission also recommended that any simplification proposal limit sales and use tax rates to one per state.

Leaders of the SSTP committed themselves at the outset to achieving substantial rate simplification. Given the recommendations of both the NTA E-Commerce Project and the Advisory Commission that one rate per state is an absolute requirement for any meaningful reform of state sales and use tax systems, the SSTP could reasonably have been expected to adopt this proposal, as well. Despite the recommendations of the two previous study groups, however, the SSTP deemed the proposal too politically unpalatable for state legislatures, and dismissed the "one rate" proposal after its first round of meetings.

Further dilution of rate simplification efforts followed. Three days after the approval of the first draft of the SSTA in January 2001, the National Conference of State Legislatures ("NCSL") approved a competing form of agreement, which omitted considerable portions of the SSTA and proposed alternatives to some provisions. In particular, the NCSL version allowed states to adopt a second state rate for some products.

Under pressure from states with multiple state tax rates, some of whom warned SSTP leaders that failure to permit an additional state rate would prevent their continued participation in the Project, the SSTP buckled and conformed the Agreement to the NCSL's version. The SSTA, as presented to Congress, permits a state to adopt a "single additional rate," different from the standard tax rate, for "food and food ingredients" and "drugs." Thus, not only has the Agreement failed to reduce the number of jurisdictions, it has also potentially doubled the number of different rates applicable to vendors of any product meeting the definitions of "food and food ingredients" and "drugs."

B. The SSTA Blindly Relies On Non-Existent Tax Compliance Software, But The SSTP's Own Test Shows Such Software Cannot Be Developed.

From early in the process, the SSTP envisioned the development of new tax compliance software that would allow multi-state marketers to automate tax collection and reporting requirements. This was described as a "vital element" of the new "streamlined" system. Such fully-functional tax compliance software is the Project's "silver bullet" to slay the otherwise overwhelming complexities of differing state tax systems. To this date, however, no such system has been developed, nor is there any indication that such a system is even feasible.

In the summer of 2000, the SSTP invited software providers to participate in a pilot program to develop tax compliance software which would perform the function of sales tax administration for a retailer required to collect and remit sales/use tax in four different states ("Pilot Program"). The Project awarded contracts to three vendors in September, 2000. The results of the Pilot Program raise serious doubts about the viability of developing tax compliance software under the SSTA.

First, the Pilot Program did not test the multi-state system envisioned under the SSTA. The program was limited to testing compliance with the laws and reporting requirements of only four states (Kansas, Michigan, North Carolina, and Wisconsin), not all forty states, including thousands of local tax jurisdictions, now participating in the SSTP. At the time of the test, which was conducted primarily in 2001, the SSTA was not yet approved, and thus none of the state systems being tested had adopted laws purportedly conforming to the requirements of the SSTA. Indeed, each of the four states maintained a unique payment and returns processing system. Moreover, basic features of the SSTA, such as electronic filing, were not available to the pilot states. In sponsoring the Pilot Program, the SSTP simply did not perform a relevant test.

The results of the Program, however, demonstrate that viable tax compliance software for a system such as the SSTA remains a figment of the SSTP's imagination. The Pilot Program failed to develop software that could successfully administer the tax systems of only four of the states participating in the program. Of the three vendors initially awarded contracts, only two produced a system that performed well-enough on the limited number of transactions tested by the participating states to be provisionally certified by the states as approved service providers. Of these two vendors, one never used its system to perform actual transactions on behalf of a retailer and later that vendor withdrew from the project in October, 2002. The remaining vendor secured approval from four retailers to collect and remit tax using its system, but ultimately was able to perform such functions for only a single retailer.

Even more telling than the failure of the vendors to develop successful software, however, are the inherent institutional and systemic obstacles the Program revealed to development of a tax compliance software solution for the problems of collecting and reporting tax in a multi-state environment. System compatibility and integration challenges present an enormous hurdle. The Program showed that states will have to adapt their processing systems to accommodate a CSP's reporting and remittance processes. With 40 SSTP states potentially facing compatibility issues for every new Service Provider and for every retailer that develops its own software in-house, this problem alone is likely to cripple the system. In addition, software vendors participating in the Program reported substantial difficulties in integrating the vendors' software with the computer systems of potential retailers. Such problems were so substantial that some retailers backed-out of the Pilot Program because such issues could not be resolved. If vendor-retailer integration proved a significant problem for the handful of retailers that participated in the Pilot Program, imposing mandatory tax compliance upon the hundreds of thousands of retailers in the United States that would be subject to the SSTP would surely prove a nightmare.

Even if pervasive system compatibility and integration issues did not threaten to cripple the SSTA system, the Pilot Program showed that the lack of adequate provisions for testing and certifying compliance software would doom it to catastrophic failure. The SSTA grants the Governing Board, composed of member state representatives, rather than an independent technology firm, the responsibility for certifying Service Providers and Automated Systems. There is no basis for believing that a Governing Board of state tax administrators has the expertise to assess such new technology. Indeed, the States participating in the Pilot Program reported that their representatives lacked the expertise necessary in software design and development to do any more than test whether the program accurately calculated tax on a limited number of sample transactions. (Even this extremely limited review revealed Service Provider errors.)

Independent and verifiable testing and certification of CSPs and CASs should be required. Under the SSTA, the Governing Board will be called upon to certify systems it is not capable of evaluating, and then expect retailers to use those systems in the operation of their businesses. System failures and rampant errors are inevitable. The SSTP blithely ignores the massive business disruptions that are certain to occur.

Not surprisingly, both retail and computer industry representatives have expressed serious doubt that development of a technological solution to the problem of multi-state sales and use tax collection is feasible. States have yet to prove through independent sources that a system can be developed that is "business friendly." Nonetheless, Congress is now being asked hastily to bless the SSTA, and expand state tax jurisdiction, even though the keystone of the Project, *i.e.*, fully-functioning compliance software, is still nowhere in sight. Having made technology the lynchpin of its program from the start, it is incredible that the SSTP would come to Congress without a fully-developed, fully-tested software solution. Certainly, such a compliance system should be "road tested" before the states ask Congress to impose mandatory tax collection duties on interstate merchants.

C. The SSTP Abandoned Its Commitment to Protect Consumer Privacy.

Privacy and the confidentiality of personal information are of fundamental, and increasing, concern to Americans. At the outset of the Project, protecting consumer privacy was one of the principal objectives of the SSTP. The Project leaders initially considered a set of privacy standards designed to protect consumers, which standards would apply to all participants in the system. The SSTP's commitment to consumer privacy proved fleeting, however. The standards were soon dropped, and the final version of the Agreement includes only vague statements regarding privacy.

In its current form, the SSTA represents an unprecedented threat to the private personal and financial data of millions of American consumers.

To enable tax reporting and remittance, as well as the performance of audit functions, the SSTA system will collect massive amounts of information regarding consumer transactions. That information will be retained and made available not only to state tax auditors (who are authorized to share the information with their colleagues in other states) but also to the private companies that are designated to act as "Certified Service Providers." Consequently, confidential on-line customer transaction information will be distributed widely both within various state government agencies and among private companies.

The Agreement contains no substantive confidentiality standards or privacy protections, and it allows the Certified Service Providers to self-certify the adequacy of their privacy safeguards under this standardless structure. The Agreement contains no mechanism for monitoring treatment of confidential customer information, such as a compliance review by an independent auditing firm. The Agreement provides no enforcement provisions or consumer remedies for breaches in protecting confidential information. By itself, these inadequacies represent a shocking disregard for consumer privacy on the part of the SSTP member states; and in light of the proliferation of credit card fraud and identity theft crimes in recent years, the SSTA poses a new threat to millions of American consumers.

The Agreement should include, at a minimum, (1) detailed provisions restricting access to consumer information and requiring that such information should be purged after tax payments have been properly credited, (2) supervision of every public agency and private entity that collects or has access to such information by an independent monitor, and (3) strict penalties—including criminal sanctions—for breach of privacy standards. Americans are entitled to know that their state governments are doing the utmost to protect their privacy in connection with information turned over to the government. Congress should refrain from endorsing the widespread dissemination of consumer transaction information in the absence of stringent privacy protections.

D. The SSTA Fails To Reduce Administrative Burdens On Retailers.

Genuine uniformity and simplification through a multi-state compact should include extensive centralization of administrative functions, including not only registration, but also tax reporting, remittance and audit procedures. Although originally committed to simplifying administration of sales and use taxes for sellers, the participating state representatives repeatedly abandoned reforms that would have made the system more uniform. For example, adoption of a uniform sales tax return was rejected because it would have required participating states with more complicated information-rich reporting requirements to simplify their sales and use tax returns. Early proposals for joint audits (*i.e.*, audits conducted on behalf of more than one state) are not included in the Agreement. Even the vendor registration requirements are left open-ended. The Agreement purports to require a single registration procedure for all participating states, but then in a separate provision the SSTA provides that retailers may be required to provide additional information "[i]n member states where the seller has a requirement to register prior to registering under the Agreement." This provision gives states a license to demand additional registration information from sellers.

Rather than simplifying the administrative burdens faced by multi-state marketers, the SSTA would actually *extend* the burdens of use tax administration to a whole new class of merchants. A direct marketer doing business nationwide will need to file not one, or perhaps a few, returns each month, but instead will be required to file returns in every one of the 45 states, and the District of Columbia, that impose sales and use taxes. Worse still, the interstate merchant will be subject to audit at any given time by forty-six different revenue departments. For multistate retailers, the obligation to file literally dozens of sales tax returns each month, and then be subject to audit by every state, will be enormously burdensome and expensive. Indeed, many retailers will find themselves in a state of perpetual audit. How is this tax reform? A fair system would permit a single audit on behalf of all member states and local tax jurisdictions (*e.g.*, by the revenue department of the state where the vendor is headquartered). The DMA proposed to the SSTP that the states appoint a vendor's "home" state to conduct the audit function on behalf of all of the other member states. This request went unanswered.

The problem is not limited to a business being subject to as many as 46 separate audits each year. Should a company disagree with the auditor's conclusions, the retailer must pursue administrative appeals, and possibly litigation, in a distant forum. The costs of contesting tax assessments will be prohibitive. Businesses will be forced to decide at what threshold dollar amount a challenge to a distant state's tax assessment even makes sense. For example, does a company headquartered in Florida challenge an assessment by the California Board of Equalization in the amount of $10,000? $20,000? $50,000? In many instances, it will simply make more sense for the retailer to swallow hard and pay the assessment, rather than hire legal counsel and spend the time and money to contest the issue in a hostile administrative forum far from its home state.

E. The SSTP Failed To Conduct A Promised Cost Of Collection Study, Necessary To Evaluate The True Costs of The Expanded Tax Collection System It Seeks To Impose On Interstate Marketers.

The SSTA would draft thousands of remote sellers into the role of tax collection agents for the participating states. Sellers incur substantial expense in collecting and remitting sales and use taxes to states. The variety and inconsistency of state tax systems makes compliance expensive for all multi-state retailers, but especially for low volume merchants. A study by a major accounting firm reported that for companies selling products nationally with collection responsibilities in all of the 45 states that have sales and use taxes, the costs of compliance ranged from 14 percent of the sales taxes collected for large retailers, to 48 percent for medium-sized retailers, to 87 percent for small retailers. States and municipalities do not reimburse multi-state retailers for their real costs incurred in collecting use taxes. Indeed, in most states, reimbursement rates, in the form of vendor discounts, are either nonexistent or nominal.

The SSTP published a proposal for a Public-Private Sector Study of Cost of Collecting State and Local Sales and Use Taxes in 2001. The project was put to bid in late 2001, and subsequently awarded to a major accounting firm. Although the proposal required the contractor to report to the SSTP within 180 days of the award of the contract, or by July 2002, no cost study has ever been performed.

The SSTA "anticipates" that member states will provide a limited measure of compensation for remote sellers. The SSTP, however, still has no idea what compliance costs the new system will impose on remote sellers. These costs could conceivably outstrip the tax amounts collected by retailers. If compensation by the states is inadequate, those collection costs will be passed on by retailers to their customers in the form of increased prices. The SSTP is asking Congress to approve a system whose true costs to retailers, and, by extension, to consumers, it simply does not know.

F. The SSTA Fails To Ensure Compliance With The Terms Of The Agreement By Member States.

Even with the watered-down standards of the SSTA in its current form, *i.e.*, "low bar" tax reform, the Agreement does not require strict compliance with those standards by participating states. The first draft of the Agreement provided that a member state's laws "must comply" with the requirements of the Agreement. The National Conference of State Legislatures, however, took exception with the strong compliance language in the SSTP version. Rather than requiring strict compliance, the NCSL proposed that states need only "substantially comply" with the Agreement to become and remain a member.

Not to be outdone, the SSTP adopted an even weaker and more ambiguous compliance standard for member states. Now a member state is in compliance with the Agreement if "*the effect* of its laws, rules, regulations and policies is *substantially compliant* with each of the requirements of the Agreement." This vague compliance standard does nothing to guarantee that a state has simplified its laws even to the limited extent contemplated under the Agreement. Moreover, since only the overall "effect" of a state's tax policies is required to "substantially" comply with the Agreement, state regimes may vary from the specific terms of the Agreement in countless ways. The SSTA assures no uniformity at all even for its modest standardization provisions.

III. THE DILUTED AGREEMENT ADOPTED BY THE SSTP IS NOT MEANINGFUL SIMPLIFICATION AND IS FUNDAMENTALLY UNFAIR TO RETAILERS.

The SSTP's total retreat from its own standards for a truly simplified system is reason enough for Congress to ask the states to return to the drawing board. A comprehensive review of the SSTA, however, reveals not only a failure to achieve the Project's original objectives, but, in addition, the inclusion of many other features that would deny fundamental fairness to interstate marketers.

A. The Agreement Means Enormous New Obligations Compared To The Present System, So It Is Not Simplification At All.

Although the proponents of the SSTP tout the Agreement as tax simplification, if the Agreement is coupled with a legislative repeal of *Quill*, it is just the opposite. Under the current constitutional standards embodied in *Quill*, retailers without a physical presence in a state have no sales/use tax collection responsibilities to that state. Under the Agreement, however, retailers will be confronted with an entirely new obligation to collect tax for over 7,500 jurisdictions. The Agreement thus creates an enormous increase in the complexity of doing business for interstate marketers, certainly not a move towards simplification.

B. There Is No Reduction In The Number Of Tax Jurisdictions, And The Number Of Tax Rates Could Go Even Higher.

As I explained in Section II.A of my testimony, the Agreement does not reduce the number of tax jurisdictions, the fundamental cause of complexity in the current system. In addition, because the Agreement allows each state to adopt a second rate at the state level, when coupled with the existing variations in local rates, the current number of different tax rates could increase, not decrease, under the Agreement.

Other provisions of the SSTA allow a state to craft even more non-standard rates. The Agreement allows states to continue the popular practice of sales tax "holidays," creating temporary additional "zero rates" for designated items. To make matters worse, the Agreement allows the states to establish "thresholds" during state tax holidays, so some of the additional zero rates will only apply above a threshold item price or purchase amount. The Agreement also contains no restrictions on the duration of tax holidays, so a state may manipulate the system to create additional exemptions, or to impose permanent thresholds, in violation of other provisions of the Agreement. The number of rates and their possible variations is unlimited.

C. The Agreement Does Not Require Uniform Definitions For Taxable Products.

Under the SSTA, states would to continue to determine which products are taxable and which are exempt from tax. The states' "Asolution" to the vast differences among the states with respect to what products are taxable and what products are exempt is to establish "uniform" definitions which create a "menu" from which states can pick and choose what to tax and what to exempt. (Localities can continue to define and set their own tax base of taxable and exempt goods, separate from that of the state in which they are located, until 2005.)

SSTA proponents proudly claim that the "uniformity" of definitions results in substantial tax simplification, but the wiggle-room for states is considerable. The Agreement only requires that the state adopt definitions which are "in substantially the same language" and are "not contrary to the meaning of" the definitions contained in the Agreement. Every state is thus allowed to have its own "grey area" with respect to every term defined in the Agreement. This is hardly uniformity. How is a retailer to interpret the nuanced differences in definitions among the states?

Many of the so-called "uniform" definitions crafted by the SSTP allow participating states to carve-out a variety of sub-categories of products, creating endless possible variations from state to state. Furthermore, the Agreement permits a state to enact exemptions without restriction if the Agreement "does not have a definition for the product or for a term that includes the product." This provision is an open invitation to states to impose their own interpretations of whether the Agreement "has a definition" for particular products, and it will inevitably lead to widely varying exemptions from state to state.

Put simply, even on as basic a simplification measure as uniform definitions, the Agreement comes up short. It does not provide a comprehensive listing of goods subject to, or excluded form, taxation by participating states. Examples of products for which the Agreement has no definition include such common items as farm/garden equipment and products. Under the SSTA, states will remain free to adopt disparate exemptions with respect to any "undefined" product, creating uncertainties and confusion for remote sellers and their customers. Furthermore, the Agreement is unclear as to whether whole defined categories of goods or services must be exempted during sales tax holidays, or whether individual items within a definition can be selectively exempted. The end result is that in the area of uniform definitions, supposedly the jewel in the crown of the SSTP process, the terrain remains rough and muddy for remote sellers.

D. The Agreement's "Uniform" Definition Of "Sales Price" Permits Every Member State To Use A Different Measure, So That The Taxable Amount Of A Sale Transaction Will Differ From State to State.

Another fundamental complexity of the current system is that sellers must not only track the myriad of taxes and exemptions from state to state in order to determine whether their products are taxable in each state, but they must also determine the amount of each transaction that is subject to tax. This is especially problematic for remote sellers, who often add shipping and handling charges to the product's sale price. Under the current system, states treat such charges in a variety of ways, making calculation of the tax due in each state difficult for both the merchant and its customer. Uniformity among states with respect to the measure of sales and use tax is an important requirement of simplification.

The SSTA's so-called "uniform" definition of the term "sales price," however, does not require member states to adopt a uniform measure of tax. The Agreement provides that "sales price" means the "total amount of consideration . . . for which personal property or services are sold," including not only the product price, but also (1) any charges necessary to complete the sale, (2) delivery charges, (3) installation charges, (4) the value of any exempt property that may have been "bundled" with the taxable product as part of a single sale, and (5) the value of any property given by the purchaser as a "trade-in." The SSTA, however, allows each state to exclude from the measure of "sales price" the amount received for any, or all, of these five items, if they are "separately stated" on the invoice to the customer, creating dozens of possible permutations of "sales price." Rather than a "uniform" definition of the taxable measure of sale from state to state, sellers must track different definitions of sales price in every state.

Delivery charges are by far the most common surcharge receiving disparate state tax treatment. Taxation of delivery charges varies from state to state depending upon the nature of the charge (*e.g.*, does it cover only transportation charges, or other related costs, as well), its description (*i.e.*, a "shipping & handling" charge may be taxed differently than a "shipping" charge), whether it is "separately stated" on the invoice, and other factors. In order to simplify the difficulties of administering different rules on the taxation of delivery charges, the DMA proposed to the SSTP that all delivery charges be made exempt under the SSTA. Again, the SSTP rejected simplification in favor of permitting each state to cling to its existing rule, even adopting a definition of "sales price" that accommodates every state's particular way of defining the measure of tax.

E. The Agreement Ignores Its Impact On Consumers Who Order By Mail And Pay For Their Purchases By Check.

The Agreement ignores its impact on consumers (especially the elderly and persons with low incomes who cannot obtain credit cards) who, either by choice or necessity, order by mail and pay by check or money-order. The system envisioned by the SSTA is unworkable where payment is made by check, and this problem is significant. According to the Federal Reserve, as of 2000, checks still accounted for nearly 60 percent of all non-cash payments.

A simple example demonstrates the "real world" shortcomings of the SSTA. Let's assume a generous grandmother at Christmas decides to send several of her grandchildren located in different states the same flannel shirt (in different sizes), plus a gift basket of chocolates, chosen from a mail order catalog. When she fills out the catalog order form and attempts to pay by check, she will be required to self-compute the applicable tax. In order to accommodate her, a catalog will need to contain a tax table covering every state and local tax jurisdiction to determine the appropriate rate for her purchase. The catalog will also need to inform her which products are taxable and which are exempt in each state. (Clothing is excluded from sales tax in some states; food and/or candy is also exempt in some states.) The SSTA's "sourcing" rules provide that the tax rate for the jurisdiction where the recipient is located, not where the donor is located, applies, so she must calculate the correct tax, even on identical items, at four different tax rates. If her grandchildren happen to live in localities that impose one or more local sales taxes, she must be able to identify and apply up to four additional local tax rates, as well.

The Agreement permits every state to have a second, additional tax rate for food items. Now this buyer must determine not only whether the basket of chocolates is taxable, but whether it is taxable at a different rate than the shirt she is purchasing. (A single basket of chocolates may be subject to two different rates, one for the food/candy and another for the decorative container.) The SSTA allows states to exclude "candy" from the definition of "food." Now she must determine if "candy" is treated differently than "food" and, if so, whether it is exempt from tax or whether it is taxable at the standard state tax rate.

Now imagine that the state has adopted a sales tax holiday for one or more of the items she is ordering. (Many states, for example, have sales tax holidays that exempt clothing for short periods of time, usually from four to seven days.) This shopper must be made aware of the relevant sales tax holidays in the states where her grandchildren live in order to properly calculate her tax. Furthermore, if the sales tax holiday includes a tax threshold, she must also know the level of the threshold, and apply tax if the amount of her purchase exceeds the threshold. If, because she misunderstands or is unaware of the sales tax holiday, she over-calculates tax and overpays the retailer, the retailer now has the additional burden of deciding how to handle the overpayment. Should it be remitted to the state or returned to the customer?

The likelihood for consumer frustration and error are obvious, but the SSTA totally ignores the burdens it will impose on consumers. Moreover, the Agreement leaves retailers liable for the tax even if the consumer errs in calculating it. This is not tax simplification.

F. The Agreement's Provisions Concerning Taxation of Digital Products Are Unworkable And Unfairly Expose Retailers to Liability.

Increasingly, electronic commerce involves the sale of digital products that can be ordered and delivered over the Internet. The SSTA, however, fails to provide a workable system for taxing digital products that will be used in multiple jurisdictions. The Agreement requires purchasers of digital goods and services to allocate the use of such digital products across multiple jurisdictions and to provide the retailer a new document called a Multiple Points of Use Form. Such allocations will not only be extremely complicated for consumers, but, in addition, there is no reason why a purchaser will feel obligated to complete such a form. The retailer, however, will only be relieved of liability for the tax if it is successful in obtaining the completed Multiple Points of Use Form from the purchaser. Retailers of digital products will inevitably be assessed for uncollected use taxes in multiple jurisdictions because their customers fail to provide the proper form. Under the SSTA, a single sale of digital product could subject an Internet marketer to sales tax liability in multiple states.

G. The Provisions For Compensating Retailers And Certified Service Providers Are Woefully Inadequate.

Clearly, the SSTA, if approved by Congress as the basis for expanded state tax jurisdiction, will force retailers throughout the country to bear considerable additional expense to collect use taxes on behalf of states and localities. It is only fair that they should receive appropriate compensation, and protection from liability, for these new responsibilities. The SSTA, however, contains no guarantees of fair compensation for these additional duties.

The Agreement vaguely provides that states "anticipate" establishing compensation measures for businesses, either Certified Service Providers, retailers, or both, that incur compliance costs in connection with collecting and remitting use tax to the participating states. The Agreement, however, contain no guarantees of compensation to either retailers or CSPs. Even the "anticipated" compensation does not extend beyond the first twenty-four months of a retailer's collection of tax under the Agreement, even though the retailer will incur ongoing compliance costs. After the first two years, retailers are left to the whims of the individual member states, few of which currently provide a meaningful amount of vendor compensation, if they offer it at all. It is telling that no state that has passed legislation to conform its tax code to the SSTA's requirements has yet enacted new provisions for adequate vendor compensation.

Moreover, once states have obtained congressional authority to impose use tax collection obligations on remote sellers, state legislatures will have every incentive to decrease, or eliminate altogether, the compensation they provide, in order to maximize state revenues. Indeed, one member state with a pre-existing vendor compensation provision (Kentucky) recently slashed vendor compensation for fiscal year 2004. At the same time, CSPs can be expected to charge higher and higher administrative fees to retailers as the state reimbursement to the CSPs diminishes. A system that fails to provide guaranteed compensation for the new and ongoing costs of tax compliance is simply unfair.

As if failing to provide a guaranty of adequate compensation were not enough, the Agreement also provides that states may refuse compensation to a retailer that already had "a requirement to register to collect the tax." What does this mean? States will undoubtedly claim that marketers were required to collect the tax anyway, and thus are not entitled to collection cost compensation. Is the *Quill* nexus standard to be litigated over this continuing qualification controversy?

H. Retailers Bear All The Burdens Of Compliance, But Receive No Protection From Liability For Tax Collection Errors.

SSTA protection of vendors from liability for tax collection errors is strikingly narrow. Vendors are relieved of liability only if a tax collection error results from erroneous information supplied by the state. Vendors are not relieved of liability if a state fails to give, or the vendor fails to receive, adequate notice of a change in the tax rate or jurisdictional boundary. The Agreement also contains no provision relieving sellers of liability for errors due to certified software errors or system failures by CAS's or CSP's. Given the total lack of adequate tax compliance software, this omission by the SSTP is astounding.

Although imposing massive new burdens on retailers to collect use taxes in over 7,500 jurisdictions, the Agreement includes no protection for retailers from consumer lawsuits for collection errors committed in good faith by the retailer or by Certified Service Providers or as a result of software errors and malfunctions. A fair system would include protection from consumer lawsuits for a retailer collecting tax in good faith on behalf of thousands of jurisdictions. Indeed, class actions against direct marketers alleging over-collection of use tax are not uncommon. Instead of protection from suits, the Agreement contains only a cryptic provision which requires consumers to demand a refund from the retailer and give the retailer sixty (60) days to respond before bringing suit. Rather than protecting sellers, this provision arguably creates a new cause of action for consumers and exposes retailers to lawsuits in jurisdictions where consumers' only previous remedy was a refund claim against the state.

I. The Agreement's Governance Provisions Allow The States To Police Themselves.

Enforcement of member state compliance with the requirements of the SSTA, under the Agreement's weak "substantially compliant" standard, is left to a self-regulating Governing Board. The contemplated SSTA Governing Board will be composed primarily of state tax administrators, who obviously have no incentive to declare a fellow member state out of compliance with the Agreement. Moreover, by the terms of the Agreement, the Governing Board is given sole and final authority to interpret the Agreement. There is no role for judicial review of decisions of the Governing Board, either as to issues of member state compliance or interpretation of supposedly uniform standards.

In the unlikely event that the Governing Board finds a member state to be out of compliance, it is not required to deny that state continued participation in the SSTA or even to sanction the state in any way. Moreover, a vote to sanction a state requires a three-fourths majority of the Board. Needless to say, with so few enforcement mechanisms, and so little incentive for a state to remain in compliance, it is unlikely that states will adhere strictly to the terms of the Agreement.

J. The Agreement Has No Mechanism To Guarantee Consistency and Uniformity Over Time.

The SSTA is not self-executing. Individual states must pass legislation to bring their tax codes into conformity with the requirements of the Agreement. Even assuming that the initial legislation in each state brings the state into compliance with the Agreement (and that's a big assumption, even under the Agreement's soft "substantially compliant" standard), there will never be more "uniformity" among the states than on the first day the Agreement goes into effect. After that date, uniformity starts to fray. State revenue departments, as well as administrative tribunals and courts in each member state, will independently interpret and apply each state's purported conforming legislation. With numerous, independent decision-makers rendering their own interpretations of SSTA conforming legislation, divergent interpretations are inevitable. Thus, the "substantial uniformity" the Agreement purports to establish on day one will progressively deteriorate over time. The "streamlined" system envisioned under the SSTA will gradually fall apart.

K. The Agreement Allows No Judicial Review of Board Decisions.

The Agreement's purported "solution" to the problem of inconsistent interpretation is to empower the Governing Board to issue interpretations of the Agreement and of its definitions, in response to a petition from a member state or any other person. The Governing Board, however, is not required to act on any petition. Moreover, because all actions by the Governing Board (including any failure to act) are final and not subject to further review, a retailer or taxpayer has no recourse from an adverse decision of the Governing Board. Even if a retailer or taxpayer obtains a favorable ruling from the Governing Board, the Agreement makes clear that no person, other than a member state, is entitled to benefit from the Agreement, and that neither the provisions of the Agreement, nor the actions of the Governing

Board, afford any person affirmative rights under state law. The states have made themselves, through the Governing Board, the sole and final arbiters of all matters under the Agreement, and they have insulated themselves from taxpayers' protests of assessments based on the argument that the state has failed to abide by the terms of the SSTA. The states are asking Congress to bless a system for which the states have provided no safeguards or oversight.

L. The System Envisioned By The SSTA Is Far From Operational and Certainly Not Ready To Form The Basis For Expanded State Tax Jurisdiction.

The list of tasks not yet completed by the SSTP, which are necessary to implement even the limited and inadequate reform measures contemplated by the Agreement, is lengthy. Most glaringly, as I have pointed out, there is no software in place for retailers to calculate tax properly under this new system, nor are there any Certified Service Providers to perform a retailer's multi-state tax collection obligations. The states have also not completed their cost of collection study. Few, if any, states have established required databases of tax rates and jurisdictions. There is no basic registration form and not yet any system for centralized registration.

Although it is stating the obvious, it bears mention that since the Agreement is not yet in effect, there is no Governing Board. This is not a trivial matter. Rather than tackling a myriad of administrative issues in the Agreement itself, the states have glibly left these matters to be addressed by a still unconstituted Governing Board. As a result, there is no uniform model tax return, no model remittance form, no direct pay permit guidelines and forms, no taxability matrices, no procedures for the Governing Board itself, no rules regarding disputed issue resolution, and no advisory councils.

Consideration by Congress is simply premature. Not only are numerous elements of the SSTA still undeveloped, but many other factors are not slated to go into effect for years. For example, the provisions for limiting the number of state rates to one rate plus one additional rate, harmonizing state and local tax bases, eliminating caps and thresholds (outside of the tax holiday context, where they will continue to be permitted), and adopting a uniform rounding rule, are not required to go into effect until December 31, 2005.

In short, the list of open items is long. Congress should not endorse a tax system that is far from operational, especially when the endorsement carries with it an historically unprecedented expansion of state tax power.

IV. THE STATES HAVE FAILED TO CONFORM THEIR LAWS TO THE AGREEMENT.

While the inherent problems with the Agreement that I have described demonstrate that the SSTA, on its face, fails to achieve meaningful reform, the long descent away from true uniformity and simplification does not end there. Although some twenty states have passed purported conformity legislation, no state has, in fact, yet enacted legislation sufficient to bring its laws into conformity with the Agreement's requirements. As state after state misses the mark, the goal of uniformity grows ever more distant.

A. State Legislatures Consistently Omit Key Provisions of The Agreement.

The apparent shortcomings in state conformity legislation run the gamut. Often it is what a state has left undone, rather than what it has enacted, that causes the state to fall short. The most common omissions are both telling, and troubling. Numerous states have failed to enact provisions guaranteeing vendor compensation (including Arkansas, Iowa, Kansas, North Carolina, North Dakota, South Dakota, and West Virginia) and many have not adopted the (albeit weak) consumer privacy requirements imposed on states under the Agreement (including Indiana, Nevada, Tennessee, Utah and Washington). Other omissions include failure to adopt amnesty provisions for companies registering under the Agreement (North Carolina, Washington) and the establishment of required databases and matrices (Indiana). Texas and Washington, both states with local taxing jurisdictions, have failed to adopt the Agreement's destination-based sourcing rules. Wyoming has adopted legislation that essentially contains none of the Agreement's requirements, but instead directs its tax administrator to adopt as-yet unfinished regulations to meet each of the requirements. West Virginia has adopted the Agreement verbatim, but has retained conflicting definitions from its existing statutes, providing only that the new definition shall control in the even of a conflict. The list goes on.

B. States Have Renamed Taxes And Crafted Other Creative Legislation To Circumvent The Agreement's Requirements.

In a development that may bode even greater ill for the goal of simplification, some states have already demonstrated their willingness to circumvent the requirements of the Agreement through legislative gamesmanship. Under prior law, Minnesota had an exemption for most clothing, but imposed sales/use tax on fur coats. The SSTA, however, requires that a state exemption must apply to an entire defined category of goods, in this case clothing. Because furs are deemed "clothing" under the Agreement, Minnesota would be required to include fur coats in its sales tax exemption for clothing. Rather than conform its laws, however, Minnesota enacted a separate "special fur clothing tax," outside of its sales and use tax statutes.

Tennessee has engaged in similar legislative slight-of-hand. Rather than conform to the requirements of a single state rate (for all items other than food, food ingredients or drugs), Tennessee adopted certain "special user privilege taxes" which impose disparate tax rates on select products and services. Here again, the state simply renamed an existing provision to avoid application of the Agreement, rather than accepting the modest measure of simplification required under the SSTA.

The danger that states will resort to imposing individual "excise" and other "special" taxes on various items that would not be subject to sales tax under the Agreement's terms is very real, as demonstrated by these examples of early circumvention tactics. The Agreement, by its terms, applies to sales and use taxes, but it nowhere defines either form of tax, leaving states free to game the system, and introduce still more complexity. Once Congress grants the states expanded tax jurisdiction, the incentive for state legislatures to yield to local pressures and evade uniformity strictures will only increase.

C. Conformity Legislation Is A Vehicle For State Tax Increases.

Purported state conformity legislation is being used by some states to impose tax increases on their residents. In fact, several provisions of the SSTA will allow, or even require, states to increase their sales and use taxes when conforming their laws to the Agreement. For example, at least four participating states (Illinois, Iowa, Kansas, Vermont) have a local sales tax (or the equivalent) but have no local use tax. Although the SSTA would permit this discrepancy to continue, at least one state, Kansas, has used its conformity legislation to impose a new local use tax on consumers.

Other provisions of the SSTA will also result in tax increases as states conform their laws to the Agreement. The SSTA limits states to one state tax rate, plus one additional rate for food and food ingredients and drugs. States that tax other products at a rate lower than the standard state rate will be required to either exempt such products altogether, which is not likely, or increase the tax rate on those products. For example, agricultural equipment has been taxed at a lower rate by many of the states participating in the SSTP (*e.g.*, Florida, Mississippi, Nevada, North Carolina, North Dakota, South Dakota, Wyoming). Unless those states adopt new exemptions and remove those items altogether from the tax base, farmers in those states can expect to pay higher sales and use taxes on purchases of agricultural requirement.

The elimination of caps and thresholds, a necessary step for simplification, will also result in tax increases. Numerous states participating in the SSTP have either caps or thresholds, or both, which must be eliminated from state law in order to conform to the SSTA. Some tax increases have already been enacted as a result. Arkansas's conforming legislation eliminated its "single item" cap of $2,500 (*i.e.*, no tax on the value of a single item over $2,500) on most items, thereby raising taxes enormously on many "big ticket" purchases. Tennessee had several thresholds for selected goods and services (from caskets to cable television) which exempt such items from tax on amounts below a specified threshold. Tennessee's conformity legislation provides for the repeal of at least some of these thresholds (*e.g.*, the $500 threshold for caskets will be eliminated), subjecting its residents to new taxes. There will be many more examples of new taxes, or increased tax rates, resulting from adoption of the SSTA.

V. THE AGREEMENT WILL HAVE HARMFUL, POTENTIALLY DISASTROUS, EFFECTS ON THE ECONOMY AND AMERICAN JOBS.

Small and medium-sized businesses will suffer most from the new burdens imposed by the SSTA. Start-up companies and existing store-front businesses that might otherwise seek to establish new markets for their products by selling over the Internet will be deterred from entering e-commerce because of the specter of nationwide tax collection responsibilities. In its current open-market form, the Internet is a spur to economic growth. It enables small businesses and niche retailers to compete with big box mall merchants and sell their goods worldwide. Imposing new tax collection obligations on e-commerce will stifle the growth of the Internet and slow down this country's economic recovery which is dependent on a rebound of the information technology sector.

A. The SSTA Will Not "Level the Playing Field" Between In-State and Out-of-State Merchants.

Somewhat cynically, proponents of the SSTA claim to champion local "Main Street" merchants that must collect sales tax on their over-the-counter sales. These cries for a "level playing field" for in-state and out-of-state merchants are both misleading and short-sighted for the following reasons.

First, the cost of use tax collection and remittance is much greater for remote sellers, who must compute, collect and remit tax for thousands of jurisdictions, as compared to an in-state retailer who collects at just one tax rate. Second, direct marketers must "eat" the applicable tax if their customers fail to calculate the tax correctly—a problem storefront retailers do not confront. Third, in-state retailers benefit from a wide variety of state and local government services and programs (including tax incentives) that are not available to out-of-state merchants. Fourth, there are inherent differences in the cost of doing business for in-state and out-of-state merchants that have more of an impact on their relative competitiveness than does collection of sales tax—most obviously, an out-of-state vendor imposes delivery charges (usually in an amount considerably greater than the use tax) to get its product to the customer, while a vendor selling over-the-counter does not add a delivery surcharge to the price of its goods.

The real competition for "Main Street" shopkeepers comes, not from out-of-state sellers, but from retail behemoths in the form of big-box chain stores. Those are the companies that have devastated America's downtowns. Indeed, the advent of the Internet has allowed traditional "Main Street" merchants to develop new markets for their goods across the country. It is not surprising that the retail giants, which seek a virtual oligopoly over consumer sales, are the main advocates for increased tax obligations on e-commerce transactions. Indeed, the Walmarts, Targets, etc. will be the real beneficiaries of a tax system that requires their Internet competitors to collect tax on every sale, regardless of location. America's economy, and its small and medium-sized Internet businesses, will be the losers.

B. The SSTA Will Hurt the Competitiveness of American Companies and Favor Foreign Firms, Hampering Economic Recovery and Causing the Loss of American Jobs.

Not only is the "level playing field" argument not valid as between in-state and out-of-state merchants, but, more significantly, the SSTA would slant competition in an entirely different direction, much to the detriment of American companies and to the benefit of their foreign competitors.

Obviously, the SSTA does not, and cannot, extend the jurisdictional reach of state and local taxes to foreign companies. Although, in the past, foreign retailers may have been at a competitive disadvantage in marketing products directly to American consumers, the delivery delays of prior years and the previous expense of overseas transportation no longer impedes international (cross-border) sales. Digital products and services can be delivered electronically to American consumers from anywhere in the world. Even tangible personal property can now be delivered via common carrier from such overseas locations as China and Ireland in times, and in many cases at rates, that are no different than for domestic deliveries. And since a foreign vendor is not required under the SSTA to charge sales tax or recoup from customers the cost of collecting it, the impact of the SSTA will be to drive Internet purchasers to foreign vendors for both digital products and hard goods. (Many consumer electronic products are manufactured in the Far East, and those goods could be delivered directly to American consumers from Asian warehouse/fulfillment centers without going through the additional distribution level of an American distributor. In fact, goods can be delivered from Asia to American households using the same common carriers, such as FedEx and UPS, as are used by U.S.-based retailers. The process would appear seamless to American consumers, with no loss of convenience to them.)

The long-term economic impact of the SSTA should not be underestimated. American retailers will lose market share to foreign competitors that already enjoy substantial advantages in labor costs. E-merchants and catalog companies will locate themselves where the costs of doing business and the tax environment are most attractive. Large sectors of the direct marketing industry are already under considerable pressure to move overseas. For example, many computer programming and data entry functions have been relocated to India. English-speaking call centers have also been set up in India to handle real-time orders from American consumers. Digital products can be sold and delivered to American consumers as easily from Bombay as from Silicon Valley.

Large fulfillment centers for delivering goods to American consumers are already up-and-running in foreign countries from Mexico to China. Whether the product is apparel or computers, consumer goods can be manufactured and delivered from integrated manufacturing/warehouse facilities in Tijuana or Taipei as easily as, and less expensively than, a facility in Tennessee. The loss of American jobs to foreign countries has reached near crisis proportions, and it denominates the "jobless recovery." It would be ironic for this Congress, which is attempting to reinvigorate the U.S. economy, to instead accelerate the flow of jobs overseas by imposing new burdens on the very economic sector in which the United States has been the unchallenged world leader, *i.e.*, electronic commerce.

Parochial state and local tax systems should not be permitted to hinder America's economic recovery and its continued leadership in the field of information technology. Any attempt to saddle electronic commerce with new state sales and use tax burdens would prevent electronic commerce from achieving its full potential. Sacrificing American Internet dominance at the alter of state taxes is simply bad public policy.

VI. DIRE PREDICTIONS OF STATE REVENUE "LOSS" FROM E-COMMERCE ARE GROSSLY OVERSTATED.

The current budgetary problems confronting many states have created an impetus for states prematurely to press Congress for legislation overriding *Quill* and authorizing an expansion of state tax jurisdiction. The dire predictions of revenue losses resulting from allegedly untaxed e-commerce purchases, however, are based on unsubstantiated and grossly overestimated projections, which are refuted by recent data concerning e-commerce transactions released by the Department of Commerce.

The bleak revenue picture painted by SSTA proponents was based on a much publicized study prepared by the University of Tennessee's Center for Business and Research conducted in 2000 and updated in 2001 ("Tennessee study"). The Tennessee study relied on proprietary projections from a private consulting group, Forrester Research, which both misunderstood the nature of business-to-business electronic commerce, and grossly overstated the future growth of e-commerce. First, the Tennessee study included in its measure of electronic commerce all business-to-business transactions conducted via electronic data interface ("EDI"), a system that has been in use for years. States already receive most of the tax revenue relating to EDI transactions, because these are all business-to-business transactions, and use tax is regularly self-reported on most B-to-B transactions. Consequently, the Tennessee study's estimate of revenue loss from consumer Internet transactions is greatly inflated.

Next, the Tennessee study assumed an annual growth rate for e-commerce of 38 percent. This staggering growth rate may have looked rational during the dot-com boom, but subsequent experience has brought growth projections for the Internet back to earth. Indeed, data subsequently published by the Department of Commerce debunks the assumption of phenomenal growth rates for e-commerce over the coming decade, deflating substantially the likely impact of e-commerce on state sales tax revenue. Projections from this year's Census Bureau data show that Internet commerce is growing at a much more modest 12.5 percent compound annual growth rate.

Dr. Peter A. Johnson, a Senior Economist with the DMA, conducted an analysis in late 2002 and early 2003, based on the new Commerce Department data ("Johnson Study"). The Johnson Study projects revenue losses for the states some 80 percent to 90 percent lower than those projected by the Tennessee study. For example, for 2001, based on Commerce Department data, the uncollected use tax from Internet sales amounted to approximately $1.9 billion for all states, rather than $13 billion, as projected by the Tennessee study. The Johnson Study further projects that uncollected sales tax in 2011 will not likely exceed $4.5 billion, or less than 10 percent of the $55 billion projected by the Tennessee study. (A copy of the Johnson Study is submitted with my testimony and is available at *www.thedma.org/taxation/CurrentCalculationofUncollectedSalesTax.pdf.*) In short, the states' claims of lost revenue from e-commerce sales are based on inaccurate transaction data and are grossly inflated. Congress should not rush to approve a new system of taxation whose adverse impact on the U. S. economy is likely to be far greater than any increases in state tax revenues.

VII. IF CONGRESS EXPANDS STATE TAX JURISDICTION OVER INTERSTATE COMMERCE, THE TAX INJUNCTION ACT SHOULD BE REPEALED AND FEDERAL COURTS SHOULD HAVE JURISDICTION OVER TAX DISPUTES ALLEGING VIOLATIONS OF FEDERAL LAW.

When, and if, the states present Congress with a truly streamlined sales and use tax system, Congress should include in any authorizing legislation federal court jurisdiction over tax disputes involving questions of federal law. If states, through federal legislation, seek to remove existing constitutional limitations on the scope of their taxing jurisdiction and to impose collection obligations on companies located in other states, then such companies should have access to federal court both to challenge decisions of the Governing Board and to contest tax assessments that violate the provisions of the new federal legislation or, for that matter, any remaining constitutional protections such companies may have.

Accordingly, legislation that would override the constitutional restrictions on state taxing authority reaffirmed in *Quill* should be accompanied by a repeal of the Federal Tax Injunction Act, 28 U.S.C. § 1341, as it applies to sales and use taxes administered under the Agreement. The Tax Injunction Act was enacted to permit states to administer their tax systems *within their own borders* without interference by federal courts. This rationale no longer applies in the situation where states are enforcing their tax systems on sellers outside of their borders and pursuant to authority granted by federal legislation. Moreover, only federal courts can assure consistent interpretation and application of the Agreement among all the states.

If the SSTP member states are sincere in their expressed desire for greater interstate uniformity, federal court jurisdiction would ensure both continuing state compliance and the ongoing consistency of interpretation necessary to achieve sustainable simplification of state sales and use tax systems. Moreover, judicial review of actions of the Governing Board, including its decisions to take no action when presented with a petition, is a fundamental safeguard to avoid creating a runaway tax bureaucracy designed by, enforced by, and adjudicated by state tax administrators. Access to federal court is a procedural bare minimum that Congress should require as a quid pro quo for expanded state tax jurisdiction.

CONCLUSION

In conclusion, I want to thank again the members of the Committee for the opportunity to offer this critique of the Streamlined Sales and Use Tax Agreement. I urge Congress to move cautiously in this area, as the consequences of removing constitutional protections for interstate commerce are dramatic and may cause permanent economic harm. Once approved, such an expanded state tax system would be difficult to repeal, even if it fails to provide meaningful simplification and harms America's national interests in other ways. Congress may have only one chance to "get this issue right." Until the states can demonstrate to Congress' complete satisfaction that they have developed a fair and fully functioning system that achieves more than superficial simplification, and that contains safeguards for marketers and consumers, Congress should decline to alter constitutional standards that have served this country well since its founding.

ATTACHMENT 1

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August 4, 2000

Frank Shafroth
National Governors Association
Streamlined Sales Tax Project
444 N. Capitol Street, NW, Suite 425
Washington, DC 20001-1538

RE: Direct Marketing Association - Sales/Use Tax Reform Proposals

Dear Frank:

On behalf of the Direct Marketing Association, please find enclosed several sales/use tax reform proposals which it believes should be incorporated into any interstate compact designed to simplify and harmonize the existing morass of disparate state sales/use tax laws. DMA recognizes that the existing system arose in an economic environment significantly different than that which now confronts interstate marketers. Both states and multistate merchants are now at an historical juncture where their combined efforts, along with those of Congress, could result in a substantially reformed sales/use tax system designed for the commercial and revenue needs of the 21st Century.

It is my understanding that the NGA's Streamlined Sales Tax Project will explore possibilities for substantial reform of state and local sales/use taxes, and that the results of those efforts will form the basis for further discussions with industry representatives and appropriate congressional committees. The Direct Marketing Association is prepared to be an active participant in this process and to engage in a constructive dialogue with state and local government officials to re-engineer the existing tax system to better serve the interests of both government and electronic commerce merchants.

I assume that you are the appropriate contact person for the Streamlined Sales Tax

BRANN & ISAACSON
ATTORNEYS AND COUNSELORS AT LAW

Frank Shafroth
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Project. After you and the other government representatives have had an opportunity to review the enclosed proposals, I would appreciate your contacting me and advising how DMA can best engage in direct discussions with the state representatives on these issues and work together toward a simplified sales/use tax system. I look forward to your response.

Very truly yours,

BRANN & ISAACSON, LLP

George S. Isaacson

GSI/dmg

Enclosure

Tax Reform Proposals
For Submission To States' Streamlined Sales Tax Project

I. TAX RATES
- A. Rate Structure
  - 1. One tax rate per state for all commerce.
- B. Frequency Of Rate Changes
  - 1. 120 day advance notice of rate changes.
  - 2. Rate changes only on January 1 and July 1.

II. TAX BASE
- A. Greater Uniformity Of Tax Base
  - 1. Common definitions of taxable and exempt products.
  - 2. Commitment among Participating States to adopt a uniform tax base within 10 years.
  - 3. Elimination of tax on shipping and handling charges.

III. TAX FORMS
- A. Standardized Forms
  - 1. Single multi-state registration form.
  - 2. Single multi-state spreadsheet-style remittance form.
  - 3. Standard resale certificate (no state modifications or varying certificate numbers).
  - 4. Standard exemption certificate and common database of exempt organizations.

IV. CENTRALIZED ADMINISTRATION
- A. Centralized Filing For Each Multi-State Vendor
  - 1. One central registration point applicable to all Participating States.
  - 2. One spreadsheet-style remittance report covering all Participating States.
- B. Administrator State - Each Multi-State Vendor Must Select A Participating State As Its Administrator State
  - 1. Administrator State is the filing point for all registrations and remittances.
  - 2. Administrator State authorized to conduct audits of the multi-state vendor on behalf of all Participating States.
- C. Audits
  - 1. A single audit on behalf of all Participating States is conducted by the Administrator State (unless the vendor requests to be audited by each individual taxing state).
  - 2. Audits will be conducted no more frequently than once every two years, unless there is reasonable basis to believe that there is fraud or financial insolvency.
  - 3. Each Participating State must give a multi-state vendor the option of submitting a protested tax assessment to a mediation-arbitration process in lieu of pursuing administrative appeals and judicial review in the individual taxing state.

V. LIMITATION ON VENDOR LIABILITY
- A. A retailer shall not be liable to a taxing state for uncollected use taxes if the customer fails to remit to the retailer the applicable tax amount in the following circumstances:
  - 1. Customers paying by credit card:
    - a) The retailer determined the applicable tax by using tax collection software certified by the state.

2. Customers paying by check or money order:
   a) The retailer provided a general notice in its advertising that applicable use tax should be included with payment.

B. Uniform Bad Debt Provisions

VI. VENDOR DISCOUNT

A. Reasonable Reimbursement Of Retailer Collection Costs

1. The vendor discount should be increased and standardized among the Participating States to reflect the actual average costs of collection to retailers.
2. Increased vendor discount should be applicable to all retailers.
3. Joint state government-retail industry panel should be established to determine the real collection costs incurred by vendors (perhaps by different categories of retailers), with an on-going responsibility to recommend adjustments in vendor discounts as cost elements change over time.

VII. SOURCING

A. Gift Transactions

1. In third-party donee transactions, no use tax should be imposed unless the purchaser and the donee are located in the same state.

VIII. CONSUMER PRIVACY

A. Limits On Demands For Consumer Information

1. States should not be allowed to require vendors to obtain any information from consumers other than that which is necessary for completion of the sales transaction.

B. Limits On Use Of Consumer Information

1. States may not use personally identifiable consumer-provided information for any purpose other than determination of use tax liabilities.
2. States will conform to privacy assurance standards and procedures (both as to audit practices and data storage) established by an independent certifying agency which will annually report on state compliance with the established standards.

IX. *DE MINIMIS* EXCEPTION FOR REMOTE SELLERS

A. National Sales By A Remote Seller Before Being Subject To Collection Duties

1. Ten million dollars (CPI adjusted based on Year 2000).

B. State Sales By A Remote Seller Before Being Subject To Collection Duties For That State

1. Five hundred thousand dollars (CPI adjusted based on Year 2000).

X. ADOPTION OF SIMPLIFIED AND UNIFORM LAW BY CRITICAL MASS OF STATES

A. Number Of States

1. 30, plus

B. Percentage National Population

1. 70% of national population must reside in those states.

XI. FEDERAL COURT JURISDICTION REGARDING UNCONSTITUTIONAL STATE TAXATION

A. Tax Injunction Act

1. Amend Tax Injunction Act to grant federal court jurisdiction over cases in which it is alleged that a state tax law or practice violates the U.S. Constitution.

B. Recovery of Attorney Fees

1. As in other cases where a plaintiff proves a state violation of a federally-guaranteed right, permit taxpayers in actions alleging a violation of their constitutionally protected rights to collect their attorney fees if successful in the litigation.

ANNOTATIONS FOR TAX REFORM PROPOSALS

I.A.1 - Multiple state and local tax rates are burdensome for all multi-state retailers, including for those which have nexus in numerous states (many DMA members fall into this category), and the great variety of rates are confusing to consumers. True tax simplification must begin by eliminating the ever-expanding number of tax jurisdictions. This was a reform measure unanimously agreed upon during the NTA Project.

I.B.1 and 2 - Catalog companies need long lead times because of lay-out and printing requirements to change their catalog copy and order forms regarding customer tax obligations.

II.A. 1 and 2 - The disparate tax base among various states is one of greatest causes of customer confusion and vendor compliance error. States should move towards substantially greater uniformity in their tax bases.

II.A.3 - The disparity among the states regarding taxation of shipping and handling charges is especially confusing to consumers, and it forces catalog companies to develop complex order forms (which look more like tax forms). As a service, delivery charges should be eliminated from the tax base.

III.A.1,2,3 and 4 - Standardization of forms is one of the easiest and least painful steps for the states to take.

IV.A. 1 and 2 - Centralized filing, with only one compliance point of contact for each retailer, is a simple and logical step towards administrative simplificaton.

IV. B. 1 and 2 - An Administrator State or "base state" system substatially reduces the administrative complexity of tax administration for multistate retailers. It has worked well for the states and the Canadian Provinces in regard to the state and provincial fuel tax obligations of interstate and international trucking firms. To the extent that states expect interstate marketers to be able to comply with a variety of state use taxes, then it is certainly appropriate to expect that the revenue departments of the Participating States will be able to administer the system (especially if simplified) on behalf of their sister states.

IV.C.1 and 2 - A single audit by the Administrator State on behalf of all Participating States can reduce the time and expense of coping with multiple use tax audits. Similarly, by limiting the frequency of audits (but permitting audits well within each state's statute of limitations), the burdens and interuptions of multiple state tax audits is reduced.

IV.C.3 - Forcing an out-of-state retailer to hire local counsel and proceed through the arcane administrative and appeal procedures of a foreign jurisdiction is one of the principal concerns of interstate retailers regarding collection of state use taxes. An elective mediation process, followed by binding arbitration of taxpayer protests, would be a quick and cost-efficient means to allow remote sellers to obtain a fair resolution of their contested assessments. Currently, many state administrative and judicial appeal procedures are simply too slow and too expensive to permit a remote seller to challenge the assessment.

V.A.1 - Changes in tax rates and taxable products present the risk that vendors will err in the calculation of applicable taxes. Certified tax collection software reduces that risk and its economic consequences.

V.A.2 - In contrast to a traditional consumer transaction conducted over a sales counter, in the remote sales context, a customer may not necessarily include the applicable sales tax in his payment, despite being asked to do so by the vendor. This is especially problematic where payment is made by check and the customer errs in his self-calculation of the tax. In those circumstances, post-sale collection of the tax is prohibitively expensive for the retailer.

V.A.B - A retailer should not be obligated to remit use tax to a state on the full value of a customer order when the retailer does not collect full payment from its customer. Currently, there is no consistent treatment of bad debts among the states. Retailers are often left holding the bag on state taxes. Similarly, on installment sales, the tax should be remitted to the state on a proportional basis as payments are received by the retailer from the consumer.

VI.A. 1, 2, and 3 - There is no policy justification for retailers being forced to subsidize the states for the expense of collecting use taxes from state residents. If states believe that retailer-collection of use taxes is the most efficient means of collecting those taxes (as compared to efforts by the states to collect the tax directly from their citizens), then the states should reimburse retailers for all the costs they incur in administering the tax collection system on behalf of the states. Indeed, in the states' "Zero Burden Proposal" before the Advisory Commission On Electronic Commerce, it was stated that the states should assume all the expense of use tax collection administration.

VII.A.1 - Many remote consumer sales involve situations where the buyer is not the recipient of the product being delivered (e.g., holiday season gifts sent to family members). Where the buyer and the donee are located in different states, there should be no use tax imposed on the transaction. (The buyer is not "using" the product in his home state, so no tax should be imposed by that state; and the donee is not the purchaser of the product, so the donee state should not impose a tax on the recipient of a gift.)

VIII.A.1 and B.1 - A reasonable de minimis threshold will minimize the deterrent effect of use tax collection on new business entering the electronic commerce marketplace.

IX.A.1 and B.1 - A reformed sales/use tax system designed to acieve substantial simplification and greater uniformity does little good if it is not widely - indeed, almost universally - adopted by the states.

X.A.1 - If state tax laws are to be given expanded national scope, then the national court system should be given authority to hear claims that the administration of those tax laws violates the federal constitution. This is especially important where the taxpayer is not a resident of the state imposing the tax obligation.

X.B.1 - Statutory provisions for the recovery of attorney fees are not only intended to reimburse successful plaintiffs for the litigation costs they incurred; such laws are also intended to deter parties (including states) from violating the constitutional rights of individuals and businesses. Any expansion of state tax authority to remote sellers carries a significant risk of new violations of constitutional law. (Indeed, case precedent is already replete with examples of state tax administrators violating the constitutional rights of taxpayers.) The threat of paying a successful litigant its attorney fees would be an important constraint on state revenue department abuse of taxpayer rights.

XI.A.1 - Many aspects of electronic commerce are instantaneous and anonymous, including some forms of payment. The growth and development of electronic commerce should not be impeded by state revenue department demands for the collection of consumer information which goes beyond that which is necessary for completion of the transaction.

XI.B.1 - American consumers are entitled to strict procedures and ironclad assurances that the information obtained by government officials will only be use for the intended purposes and not inappropriately disseminated or shared with other government agencies or private entities.

ATTACHMENT 2

A CURRENT CALCULATION OF UNCOLLECTED SALES TAX ARISING FROM INTERNET GROWTH

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Executive Summary

Is there a large and growing amount of uncollected state sales tax arising from the growth of e-commerce, such that Congress must change the definition of nexus that has been in force since the Supreme Court's *Quill* decision?

This paper contends that the most widely cited projections that purport to answer this question are based on seriously flawed assumptions regarding the nature and growth rate of e-commerce. Consequently, if Congress were to change the definition of nexus as the states are likely to request, the states are likely be seriously disappointed in the increase to state treasuries that would result.

Advocates of a change to the definition of nexus most frequently cite estimates by researchers at the University of Tennessee. Two University of Tennessee studies, authored in 2000 and 2001 using proprietary projections from the Forrester Research consulting group, estimate that uncollected sales tax from e-commerce and remote sales amounted to $13 billion in 2001, and would rise to about $55 billion in 2011.

By contrast, the analysis contained in this report is the first study to uses survey data on the size and growth rate of e-commerce as measured by the US Department of Commerce's Census Bureau. It also focuses on the real impact of e-commerce on uncollected sales taxes, arguing that it is primarily the Internet's potential substitution of out-of-state sales for in-state sales that matter for the question of uncollected sales tax, and thus might warrant a change to the definition of nexus.

By employing Commerce Department data and focusing on Internet commerce -- where revenue-adverse effects are most likely to occur -- this study shows that uncollected sales tax arising from the Internet were, in all probability, much lower. For 2001, uncollected sales tax from the Internet amounted to about $1.9 billion, and the projected uncollected sales tax in 2011 will not likely exceed $4.5 billion, or less than 10 percent of the amount projected by the University of Tennessee study.

Given these revised calculations of Internet-driven uncollected sales tax, is changing the definition of nexus the fairest and most efficient way to recoup the remaining pool of uncollected use taxes? Scholars cited in this study have reported alternative, cost-effective approaches that appear to do quite well. Kentucky, for example, raised about $12 million in self-reported use taxes from residents by simply making it a line on the state income tax form.

This study analyzes the nature, current size, and current growth rate of e-commerce because a coalition of state governments is requesting that Congress change the definition of nexus for inter-state commerce. Such a change in the definition of nexus would make it possible for states to require out-of-state sellers in the United States to collect their remote sales taxes ("use taxes") for all taxable transactions regardless of whether such sellers had a physical presence (physical nexus) in the taxing jurisdiction.

Central to the states' arguments on behalf of a widened definition of nexus is an alleged explosion in the dollar value of sales taxes lost due to the growth of e-commerce, both recently and over the next decade. The rise of the Internet, the states suggest, is rapidly diverting purchases from taxed "brick and mortar" retailers to untaxed "e-tailers."

However, as the following paper argues in detail, the Internet is not creating a massive leak in state coffers that could only be staunched by changing the definition of nexus. As most Americans are now aware, the Internet failed to fulfill many of the exaggerated hopes placed on it. When the University of Tennessee authors wrote their April 2000 study, the Internet bubble had not yet burst. Today, the dot.com boom has become a bust. Accordingly, policy makers should not be among the last to succumb to its rapidly vanishing allure. On the contrary, these authors' estimates of uncollected sales tax should be regarded with considerable skepticism -- a fact that can be understood by asking a series of basic questions.

1. How might e-commerce affect state sales tax collections?

Generally speaking, e-commerce might adversely affect states' tax revenues by making it easier to shift purchases from in-state vendors to out-of-state vendors where there is no nexus, or stimulate new purchases from such vendors. As these vendors lack physical nexus -- a substantial presence in the taxing jurisdiction -- the legal obligation to collect and remit any tax owed shifts to the purchaser. If, as the Tennessee authors maintain, all purchasers remit sales taxes to their states at a significantly lower rate than do vendors with nexus – an assumption that overlooks the enormous differences between business and consumer purchasers – an increase in the number of such transactions arising from the Internet could reduce the amount of sales tax accruing to the states.

2. What is the relevant universe of e-commerce transactions?

The Tennessee authors assume that the effects described above are synonymous with e-commerce, and that e-commerce is synonymous with the Internet. However, the supposition that e-commerce facilitates such substitutions depends on the absence of pre-existing incentives to move purchases across state lines, such as other electronic networks.

In B-to-B commerce, which plays a huge role in the Tennessee author's estimates, this is very far from being the case. For businesses, Electronic Data Interchange (EDI) preceded the Internet by several decades as the primary vehicle for B-to-B e-commercial ordering, invoicing, and remitting. Indeed, according to U.S. Department of Commerce reports, EDI and similar networks in 2000 accounted for 95 percent of the total value of manufacturers' shipments via e-commerce, while the Internet represented only 5 percent.

As this paper explains below, EDI e-commerce typically funnels purchases from a nation-wide supply chain of suppliers and sub-contractors to a single business purchaser (such as a Fortune 1000 manufacturer.) Despite being sourced nation-wide, these single-destination purchases present a comparatively simple use tax audit issue for the destination state. Although EDI transactions have been in place since the 1970s, this type of e-commerce transaction has never been shown to pose a threat of increased uncollected sales taxes that would require Congressional action to redefine nexus.

Therefore, studies of e-commerce's impact on future revenue losses that include B-to-B transactions, as the Tennessee authors do, must distinguish carefully between EDI based transactions and Internet based transactions. This study accordingly employs data from the Department of Commerce that nets out Internet from non-Internet sales, in order to avoid counting sales that already take place across state lines over EDI or similar networks, and are not relevant to any redefinition of nexus.

3. How big are Internet sales?

Data from the Department of Commerce distinguish Internet-driven sales in the B-to-B and B-to-C marketplaces more clearly than do the Forrester projections employed in the Tennessee studies. In contrast to the Tennessee estimates of $126 billion total e-commerce in 1999 and $282.7 billion in 2000 for B-to-B and B-to-C combined, the Department of Commerce reported totals of $74.1 billion and $88.6 billion, respectively, in Internet sales in those two years, for B-to-B and B-to-C combined. The failure of the Tennessee study to separate EDI from Internet sales within B-to-B is the principal explanation for its vast over-estimate of tax-relevant e-commerce transactions.

4. How fast is Internet commerce growing?

Just as the Tennessee study vastly over-estimated the size of Internet commerce, so too it relied on overly optimistic Internet bubble-era projections of e-commerce growth rates that are now very outdated. While the Tennessee studies project a compound annual e-commerce growth rate of 38 percent between 1999 and 2011, analysis of the most recent Commerce Department data projects a compound annual growth rate of a little below 13 percent over the same period, with somewhat lower growth rates in the large realm of B-to-B e-commerce. Here again, the prevalence of pre-existing networked relationships in the B-to-B world helps explains the lower rate of Internet growth, consistent with this economic data.

5. How much of Internet sales might cause uncollected sales tax?

Once one has determined the universe of Internet commerce, two further issues determine the amount of uncollected sales taxes. As the Tennessee authors point out, these issues are the amount of sales exempt from taxation, and the amount of the balance that is remitted. Each of these issues plays out differently for businesses and consumers.

In the realm of B-to-B, this study accepts the University of Tennessee's proportions of B-to-B commerce that are exempt, although they probably understate these. However, in the area of voluntary compliance by business filers, the Tennessee studies' use of a weighted 65 percent compliance rate is inconsistent with much higher estimates of business compliance consistent with the role of EDI-based filing and auditing of large manufacturers. Although other studies suggest compliance rates of up to 100 percent for businesses, this study relies upon a weighted average of 85 percent.

In the area of retail Internet commerce, the Tennessee studies implicitly assume the continuation of late 1990s "pure-play" e-tailing. In fact, the future of Internet growth has been shown to be in multi-channel, clicks and bricks. As subsequent Forrester studies confirm, consumers' desire to couple "clicks"-based shopping with "bricks"-based merchandise pick-ups and returns increasingly entails physical nexus for sales tax collection purposes. This trend further reduces the pool of transactions that would be diverted to non-taxed sales by the Internet. This study makes a marginal upward adjustment in the Tennessee study's estimated collection rate to accommodate this changed marketing dynamic.

6. What are the final implications of Internet commerce for the definition of nexus?

Applying each of the steps above to the University of Tennessee studies substantially reduces their estimates of Internet-driven losses to state coffers. At $4.5 billion in the year 2011, the most current calculation of uncollected tax from the Internet does not support the case that revenue losses are large and growing. On the contrary, the projections from the University of Tennessee study are substantially over-estimated, and appear to be based on a faulty understanding of the dynamics of e-commerce, especially in the realm of Business-to-Business transactions.

In fact, given that the vast majority of the University of Tennessee study's projected losses arise from B-to-B e-commerce shipments and sales, it certainly does not support the case that the only possible remedy for remote sales tax losses is to change the definition of nexus. If the states believe that businesses are not sufficiently in compliance on use taxes, they already have the authority to audit them more thoroughly, and without an act of Congress. Even in the realm of B-to-C e-commerce, where the effects of the Internet may be more pronounced, the revised calculations do not show that changing the definition of nexus is necessary.

Ultimately, however, the remaining definitional and measurement difficulties involved in estimating the amount of losses suffered by states from e-commerce are substantial, and argue against precipitous action. Further research into the different effects of the Internet on consumer and business tax behavior should be undertaken to more precisely ascertain the likely future impact of the key variables affecting uncollected sales tax.

A CURRENT CALCULATION OF UNCOLLECTED STATE SALES TAX ARISING FROM INTERNET GROWTH

I. WHAT IS THE USE TAX ISSUE?

The question of the appropriate role of states in the taxing of inter-state commerce is as old as the Constitution. However, since states first began imposing sales taxes in the 1930s, this question has acquired an additional dimension in the form of the "use tax." This little-known tax is now the subject of great controversy, as some believe e-commerce could make it a major source of revenue for state treasuries. To make it so, however, would require Congressional authorization.

Simply put, the use tax is a tax on out-of-state purchases that is equivalent to the amount of sales taxes that would have been paid if the same purchase had been made in state. The use tax was devised to get around interpretations of the Inter-state Commerce clause laid down by the Supreme Court, stipulating that states can legally compel only those vendors that have a physical presence in their jurisdictions to collect sales taxes. But while a tax on the "importation" of goods across state lines is not permissible, the courts permitted states to impose a tax on their residents' "use" of such items once they are imported in an amount equivalent to the lost sales tax.[1]

From an economic point of view, states impose use taxes to ensure that out of state vendors do not enjoy a competitive advantage over in-state vendors. All other things being equal, if there were no use tax, buyers at the margin might shift purchases from taxed in-state goods to untaxed out-of-state goods, entailing proportionate harms to in-state sales volumes and tax revenues, however minor.[2] Thus, the use tax nullifies, at the level of law, any economic advantage out-of-state sellers might otherwise enjoy.

It is important to bear in mind that thanks to the existence of the use tax, the legal tax burden on both in-state and out-of-state purchases is identical. The only point of difference is the identity of the remitting agent: the seller in the first case, the buyer in the second. If one were to assume full and equivalent efficiency of remittance between the two sets of economic agents (for example, 100 percent in a hypothetical economy of fully informed and spontaneously law-abiding consumers) there would be no economic distortion to trade flows and no loss to state treasuries.

The issue of relative efficiencies in remittances is the real driver of the use tax controversy. For, in the real world, the two sets of tax-remitting agents (sellers and buyers) almost certainly do not have equivalent efficiencies in tax yield. Proponents of changing nexus point out that while sellers must register with the state and can expect

[1] The same holds true, *mutatis mutandis*, for sub-state jurisdictions with their own sales tax, what is known as the local-option sales tax.
[2] Such an analysis, however, ignores the presence of shipping and handling costs for out of state purchases, which often exceed the combined 6.5 percent average state and local sales tax rate. Even without an obligation to collect tax, remote sellers have rarely enjoyed a price advantage.

to be audited, states have traditionally foregone comparable administrative oversight of consumers. Some additional percentage of those aware of the obligation would shirk it, in the belief that states do not or cannot enforce this obligation (or in the perception, as is often indeed the case, that states do not make it easy to voluntarily comply).

Of course, the hasty equating of "buyers" with consumers overlooks the fact that many purchases are made by businesses. These businesses, whether out of economies of scale in tax-filings -- or probability of being audited -- in fact remit the vast majority of use taxes currently collected. For example: both in the state of Tennessee, where there is no state income tax to facilitate use tax collections, and in the state of Maine, where the use tax line on the income tax form makes compliance for consumers comparatively easy, about 98 percent of all use taxes collected are voluntarily remitted by businesses in each state.[3] While shares of the total amounts collected do not translate automatically into compliance rates, they do strongly corroborate the claims made by other authors that business use tax compliance rate is normally vastly higher than the rate for consumers.

Whether businesses or consumers ought to remit the use tax, however, is not the question; it is a question of whether they will do so based on knowledge and cost on the part of the purchaser (whether consumer or business) on the one hand, and administrative convenience and enforcement by the state on the other.

Nevertheless, given the difference in remitting agents for sales and use taxes, there is likely to be some shift in consumption patterns and tax revenues, however marginal. The point in question has always been the magnitude of such distortions, and what should be done to minimize them. Until now, states have chosen for reasons of politics and administrative convenience, not to collect use taxes directly from consumers even though they have full authority to do so. Instead, they have historically attempted to impose the burden of collecting such taxes on uncompensated and unrepresented out-of-state sellers and have intermittently petitioned the courts or Congress to change the definition of nexus to allow them to do so.

Throughout the history of the sales and use tax, the use tax has never accounted for more than a fraction of state revenues, either absolutely or relative to the sales tax.[4] The reason for this is not the compliance issue, but rather the relatively small universe of taxable retail transactions that traditionally took place out of state, compared to those that took place in state.

[3] Maine business and individual taxpayers voluntarily remitted $75.6 million in use tax payments in 2001, of which $74.2 million, or 98.1 percent came from businesses. In Tennessee, for FY 2002, businesses voluntarily remitted an estimated $163,685,510 or 98.3 percent of a total $166,458,810 in use tax payments, while consumers remitted only $2,773,300, or 1.7 percent. Although this study did not survey all sales tax states, it believes these examples are probably representative. (Sources: Maine and Tennessee Departments of Revenue.)

[4] The exception to this rule is the use tax or its equivalent levied on out-of-state motorized vehicle purchases, such as automobiles, and boats. As such goods must be licensed to be operated, states are usually able to seek confirmation of use tax payment. Compliance (or yield) is thus effectively 100 percent for these items.

"For the first 65 years of the use tax, the typical vendor was a mail-order catalog company, and purchasing goods from such a firm was cumbersome and slow, both in placing and receiving the order. As late as the mid-1980s the revenue loss from [consumers' unremitted] use tax was modest."[5]

The states were never able to demonstrate to the courts a large revenue loss or economic distortion arising from out-of-state sales. Even in the late 1990s, wrote this same scholar, "there was no evidence that state or local governments had experienced any serious reductions in their sales tax collections" arising from remote sales, on-line or otherwise.[6]

Because a redefinition of nexus could have sweeping and unpredictable consequences for inter-state commerce as a whole and impose large compliance burdens on remote sellers, a series of Supreme Court decisions, most notably *National Bellas Hess* (1967), established that only sellers with a physical nexus -- a substantial connection such as a store, warehouse, office, or agent -- in the taxing jurisdiction could be forced to collect taxes on behalf of the state.

Subsequently, in 1992, the Supreme Court's *Quill* decision, while reaffirming that sales tax need only be collected in the event of physical nexus, broke with precedent to give future changes to the definition of nexus to Congress, not the Court. This directed the energies of those seeking to abolish the physical presence test to the halls of Congress. Although the *Quill* case gave Congress the authority to change the definition of nexus, Congress declined during the 1990s to alter the physical nexus interpretation in favor of a looser "economic" nexus rule as the states sought.

II. WHY NOW?

The use tax issue might have remained dormant, a minor addendum to the sales tax, had not the Internet boom created a perception of a radical "New Economy" with major new implications for states' sales tax revenues. This led to increased political pressure from states on Congress to change the definition of nexus.

Beginning in the late 1990s, states began to claim that remote sales derived from e-commerce threatened a large and growing erosion of their sales tax base. They claimed this could only be remedied by widening their ability to collect use taxes from out-of-state e-sellers. The *Quill* case encouraged them to lobby Congress; the rise of the Internet gave them ammunition -- or so it seemed.

Central to the states' arguments to Congress are claims regarding the amount of revenue that would be lost due to the growth of Internet sales. Today, the most frequently cited figures come from a number of studies conducted by researchers at the

[5] Cornia (2002), p. 13
[6] Cornia (2002) p. 13. See also Cline and Neubig, (1999), who make this point.

University of Tennessee.[7] Their headline number is $13 billion lost to state coffers in 2001 thanks to e-commerce. These authors further project that this number will grow to $55 billion by 2011. The states claim that these large losses represent a real policy emergency for their treasuries, which Congress must act promptly to redress.

By contrast, this paper argues that the projections offered in evidence by the Tennessee studies are greatly over-stated. They create the impression of a windfall revenue increase to state coffers by recouping taxes on transactions diverted from taxed to untaxed sellers. In fact, as this paper will show, such diversion from taxed to untaxed sales is likely far smaller than they assume.

To a very considerable degree, the headline tax revenue loss projections are the last echo of the now burst Internet bubble. The Tennessee studies rely on Forrester Research's proprietary projections of e-commerce growth. Many of Forrester's studies were conducted in 1999 and 2000, the last years -- indeed, days -- of Internet exuberance.[8] The Forrester/Tennessee studies project compound annual e-commerce growth of 38 percent -- numbers that Forrester subsequently revised downward substantially, but which are of course not reflected in the Tennessee projections.[9]

Yet as important as the over-estimation of the Internet's growth rate is to the excessive projections regarding online sales, a still more fundamental problem consists in defining the relevant universe of e-commerce. The Tennessee studies reflect dot.com bubble-era neglect of the definitional complexities underlying any effort to measure the extent and nature of e-commerce in the various sectors of the economy.

III. HOW DOES E-COMMERCE AFFECT SALES TAX REVENUES?

Generally speaking, e-commerce might adversely affect states' tax revenues by making it easier to shift purchases from in-state vendors to out-of-state vendors where there is no nexus, or stimulate new purchases from such vendors. As a secondary effect, e-commerce could also shift some purchases from out-of-state vendors who have nexus in the purchaser's state (and thus an obligation to collect sales taxes) to that vendor's "pure-play" dot.com subsidiary with no physical nexus and therefore no legal obligation to collect. (This phenomenon is rapidly disappearing, however, in favor of integrated "bricks and clicks" retailing -- see below.) As these vendors lack physical nexus -- a

[7] See the citations of their work in Cornia (2002), and GAO (2000).

[8] Forrester's studies on e-commerce include Kasrel et al (April 1999); Williams, et al (September 1999); McQuivey et al (February 2000); and Nordan et al (April 2000). Owing to the lack of specificity in the Tennessee studies, it is difficult to ascertain which Forrester studies in particular were used. However, given the September 2001 publication date, it is unlikely that the Forrester research employed could have been conducted much later than spring of 2001.

[9] The Forrester projections used by the Tennessee authors originally forecast $87.5 billion in B-to-C sales for 2002; Forrester now projects $72.1 billion for that year. The corresponding decline for Forrester's 2005 projections is from $230.6 billion to $148.6 billion, a 35 percent reduction. See Carrie A. Johnson et al., "US eCommerce: The Next Five Years." Forrester, August 27, 2002.

substantial presence in the taxing jurisdiction -- the legal obligation to collect and remit any tax owed shifts to the purchaser.

If, as the Tennessee authors assume, all e-commerce purchasers remit sales taxes owed to their states at a substantially lower rate than do vendors with nexus, such Internet-driven transactions could reduce the amount of sales tax collected by states by shifting the obligation to remit sales taxes from high-yield vendors with nexus to lower-yield purchasers.

The Tennessee calculation includes both B-to-B and B-to-C e-commerce, and implicitly assumes -- without demonstration -- that the 1990s rise of the Internet implies an equivalent transformation in the proportion of inter-state sales for both areas commerce, to the disadvantage of sales tax revenues. However, this can only be true if the Internet causes both businesses and consumers to source their purchases from out-of-state vendors at a significantly higher rate than before. The Tennessee authors focused on the then-new concept of "e-commerce," without properly defining it or distinguishing it from pre-existing economic activity.

Yet if the real question for state treasuries is: what part of e-commerce --if any -- facilitates a new diversion of in-state sales to out-of-state sources, we must recognize that "e-commerce" means very different things in the worlds of B-to-B and B-to-C commerce.

A. Business-to-Business: EDI vs. Internet.

The University of Tennessee study, written as it was during the heady days of the dot.com boom, could perhaps be forgiven for not recognizing that for businesses, "e-commerce" was not synonymous with the Internet. For the long-established nation-wide supply-chains of B-to-B commerce, the desktop networked Internet primarily supplemented -- not supplanted -- a pre-existing electronic environment of telephones, faxes, and above all, a decades-old system of networked mainframes known as "Electronic Data Interchange" (EDI).

It is over EDI networks that businesses overwhelmingly transmit their purchase orders, invoices, and payments for the manufacturing supply chain that runs from primary extraction through refining and fabrication through final assembly and delivery. As EDI pre-dates the rise of the Internet, and holds significant advantages over it, EDI severely limits the Internet's potential to increase substitutions of inter-state for out-of-state sales among businesses.[10]

[10] In point of fact, the major forces creating an inter-state market for business transactions are price, quality, and regularity of supply. These concerns originally owe much more to comparative advantages in labor costs, technology, or transportation than they do to incrementally lower "search costs" offered by digital networks. Technology and labor cost differentials, together with declining transportation costs, have been creating a national B-to-B marketplace ever since invention of the assembly line, if not the railroad. And for supply-chain transactions, the introduction of digital networks of all kinds probably

For most practical purposes, EDI made B-to-B commerce highly "wired" decades prior to the arrival of the Internet.[11] Originally designed during the era of mainframe computers, EDI is a North America-wide system of transmitting standardized documents between computers involved in the supply chain.[12] EDI began several decades ago among major Fortune 1000 industrial companies. It gained a significant boost from industry-wide standardization efforts in the 1970s. By the time the Internet came into widespread popular use a few years ago, it was estimated that some 80,000 firms throughout all sectors of the national business-to-business marketplace were already using EDI for their high-dollar value purchases and shipments.

EDI's primary value lies in the security of communications over closed electronic hubs that link stable relationships, primarily between major manufacturers and their diffuse networks of sub-contractors and suppliers, known in EDI terminology as "trading partners." Its purpose is to minimize the loss of time, security, and accuracy that arise from human data entry and re-entry on crucial documents such as purchase orders, invoices, and notices of remittance. As hundreds of billions of dollars of business processes take place over these hubs each year, security is at a premium. EDI's closed architecture makes it less vulnerable to loss than is the Internet, whose "open" architecture entails increased risks of lost data and lost transactions. These factors, together with the large sunk costs in EDI's proprietary hardware and software, mean the Internet will supplant existing e-commerce relationships only slowly, if at all. Indeed, some business processes currently conducted over the Internet may migrate to EDI as the latter's roster of standardized business documents expands.[13]

Thus, the very great size of "e-commerce" in the B-to-B realm, now and in the future, depends only marginally on the arrival of the Internet. This is confirmed by Department of Commerce reports, which note that "the dominant position of B-to-B e-commerce...reflects the long-standing use of EDI in manufacturing and wholesale trade."[14]

As the Internet does not represent a new departure in inter-state purchasing in the B-to-B realm, the Internet adds little if anything to decades old issues of inter-state sales monitoring, collecting, and compliance. On the contrary, the nature of purchasing by businesses over EDI networks is almost exactly the reverse of consumer purchasing over the Internet, and these differences matter for sales taxes.

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represents a less significant decline in inter-state communication (search) costs than did the introduction of the telegraph and telephone.

[11] While EDI processes were originally based on dial-up connections, some now take advantage of Internet connections.

[12] The North American EDI uses standards from ANSI, while European manufacturers rely upon EDIFACT.

[13] The state of Tennessee, for example, is currently using its Internet website to advertise its project for businesses to use EDI to remit taxes to the Department of Revenue.

[14] US Census Bureau, *E-stats Bulletin*, 2002, p. 2

For the state in which the manufacturer is located, it is a relatively simple matter to audit and assess appropriate use taxes from EDI transactions. EDI purchases are overwhelmingly from a number of suppliers towards a single-end user, such as a Fortune 500 transportation equipment manufacturer. Such a manufacturer has a relatively simple task of tracking purchases for which it must remit use taxes, since it may have only one jurisdiction's tax rate to calculate, and one authority to remit to. Contrast this "centripetal" purchasing dynamic with the "centrifugal" dynamic of Internet retail transactions, where a pure-play e-tailer, with customers in all 50 states, might have to calculate sales taxes for up to 7600 different remote taxing jurisdictions, if the physical presence test of nexus were overturned.

It is not surprising, therefore, that the Tennessee study offers no evidence that either the Internet or "e-commerce" significantly alters the existing ratio of B-to-B intra-state to B-to-B inter-state sales, or shifts manufacturing supply purchases from vendors with nexus to dot.com subsidiaries without nexus. Their "evidence" of a use tax problem arising from e-commerce merely amounts to the unsubstantiated assertion that "there appears to be a feeling, at least among some tax payers that e-commerce transactions are free from sales and use taxes."[15]

If the question is not vaguely defined "taxpayers," but rather businesses, this needs reconsideration. As the states had not been able to show a lack of use tax compliance during the years when EDI B-to-B transactions were growing, this claim clearly can only apply -- if at all -- to the rather small universe of B-to-B e-commerce transactions that take place over the Internet, not EDI.

B. Business-to-Consumer

Obviously, however, in consumer sales, the arrival of the Internet does make a difference. Previous retail shopping was highly decentralized and had no electronic network beyond the telephone. Inter-state commerce primarily depended on the mails for catalog delivery and fulfillment. Thus, the relevant universe of B-to-C retail e-commerce effectively implies the Internet, since it is via the Internet that we are most likely to find revenue-adverse shifts from in-state to out-of-state B-to-C sales.

While it is generally appropriate to identify retail e-commerce with Business-to-Consumer Internet commerce in government data, it is important to remember one important caveat. Not all Internet B-to-C sales represent *new* remote sales. Given the existing universe of remote sales via catalog, telephone, and other direct marketing channels, a certain percentage of Internet sales in B-to-C retail e-commerce will be substitutes for these. Any estimate of *new* uncollected sales taxes arising from the Internet alone will therefore need to net out such substitutions for existing remote sales.

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[15] Bruce and Fox (2000), p. 7

IV. HOW BIG ARE INTERNET SALES?

This study is the first analysis of the Internet sales tax issue to take advantage of new data sets on e-commerce published by the Department of Commerce's Census Bureau. As recently as 2000, the US General Accounting Office lamented that these numbers were not yet available for its own investigation of this issue. As they noted, "little empirical data exist on the key factors needed to calculate the amount of sales and use tax revenues that state and local governments lose on Internet and other remote sales. What information does exist is often of unknown accuracy.... The [Census] Bureau has plans to produce comprehensive data on Internet sales based on its annual surveys of firms in the manufacturing, wholesale, retail, and other sectors, but much of these data will not be available until 2001."[16]

Given that Census Bureau data sets lay some time in the future, the Tennessee studies' reliance on proprietary projections from Forrester research was understandable, as the best data then available. But since the development of detailed data sets from the Census Bureau on e-commerce, the quality of our data has improved substantially. Today, the Tennessee measurements of e-commerce, based on dated Forrester projections, now appear to be highly problematic.

Thus, the recent availability of Commerce Department Census Bureau data provides an unprecedented opportunity to resolve some of the major empirical uncertainties that beset previous non-governmental estimates of the size of e-commerce.[17] The Census Bureau now surveys hundreds of thousands of firms nationwide to establish a highly statistically valid picture of e-commerce utilization. On the B-to-C (retail) side in particular, its numbers are now up to date as of fourth quarter 2002. Given that Internet transactions are the issue for state revenues, the Department of Commerce statistics are especially useful in allowing us to distinguish pre-existing (EDI) networked transactions from "new economy" transactions over the Internet.

Accordingly, this study employs data from the Department of Commerce Census Bureau *E-stats Bulletins*. The Commerce Department reports two sets of numbers for B-to-B, namely total e-commerce shipments and manufacturers' wholesale e-commerce. Both of these numbers represent the value of e-commerce shipments and sales that take place over the Internet and proprietary Electronic Data Interchange and similar networks.

For its calculations, this study takes both sets of Commerce Department B-to-B data and adjusts this total universe of B-to-B e-commerce for the share accounted for by transactions over the Internet. To do so, one must first reduce the total value of e-commerce shipments for the 12 percent of shipments that are inter-plant shipments within the same firm, and then apply the respective percentages of Internet-driven transactions. For total e-commerce shipments for 2000, the Internet represented 5

[16] GAO (2000), pp. 5-6.
[17] This study refers to the "Department of Commerce" and the "Census Bureau" interchangeably.

percent,[18] and in manufacturers wholesale sales, the Internet represented 12 percent.[19] Summing the resulting two net amounts together yields the total of B-to-B Internet commerce that may represent new revenue-adverse substitutions. To this must then be added the amount of retail e-commerce transactions. Finally, as in the Tennessee studies, the total amount must then be adjusted downward to avoid counting sales in those 5 states without a sales tax

As can be seen from Table 1, the base of Internet e-commerce transactions in 2000 is considerably lower, at $86.4 billion, than the $282.7 billion reported by the University of Tennessee. The principal reason for this difference, as noted above, is the Tennessee study's inclusion of almost $200 billion in EDI or other non-Internet sales that are not relevant to the question of nexus.

TABLE 1. Internet E-Commerce, Base Years 2000 and 2001. (Analysis of data from US Dept. of Commerce *2002 E-Stats Bulletin.*) ($ Billions.)

		2000	2001
	Business-to-Business Internet Commerce		
1	Total Manufacturing Shipments--All E-Commerce	776.9	824.2
2	% Net of Inter-plant	0.88	0.88
3	Amount Net of Inter-plant	683.7	725.3
4	% Internet	0.05	0.05
5	Manufacturing Shipments--Internet Only	34.2	36.3
6	Merchant Wholesale Trade--All E-Commerce	212.8	243.1
7	% Internet	0.12	0.12
8	Merchant Wholesale Trade-Internet Only	25.5	29.2
9	Total B-to-B Internet Commerce--All States	59.7	65.4
10	Total B-to-B Internet Commerce--Sales Tax States	58.2	63.8
	Business-to-Consumer Internet Commerce		
12	Retail E-Commerce--All States	28.9	35.9
13	Retail E-Commerce--Sales Tax States	28.2	35.0
	Total Internet Commerce		
15	Total Internet Commerce--All States	88.6	101.4
16	Total Internet Commerce--Sales Tax States	86.4	98.8

V. HOW FAST IS INTERNET COMMERCE GROWING?

[18] "Manufacturing plants primarily using EDI networks for accepting online orders accounted for two-thirds of e-commerce shipments of responding plants in mid-2000 while plants primarily using Internet networks accounted for only 5 percent of e-commerce shipments." *Census Bureau E-stats Bulletin* (March 2002) p. 2.

[19] "EDI sales for merchant wholesalers...account for 88 percent of their e-commerce sales." *Census Bureau E-stats Bulletin* (March 2002) p. 2

The next issue is whether states are witnessing an explosive growth of e-commerce that is creating a policy emergency for their budgets. Simply put, the question is whether the Tennessee studies' universe of e-commerce transactions leads to inappropriate numbers regarding e-commerce growth.

Department of Commerce data create quite different pictures of the size of e-commerce and its likely growth rate than that offered by the University of Tennessee studies. Commerce Department data sets from 1999 and 2000 for B-to-B e-commerce, and data sets from 1999 through Q4 2002 for B-to-C e-commerce were used to generate baseline e-commerce sales figures for 2001 thru 2011 (B-to-B and B-to-C together) in the full table (see appendices), by fitting a trend line.[20]

As can be seen in Table 2, these results are dramatically different from what the Tennessee authors used from Forrester. Commerce Department data project a compound annual growth rate for all Internet commerce of 12.5 percent and a B-to-B e-commerce growth rate of about 11 percent.

TABLE 2. Annual Growth Rates for Internet Commerce, 1999 - 2011 (Data Source: U.S. Department of Commerce)

	Business-to-Business Internet Commerce	
11	**Compound Annual Growth Rate--1999-2011**	**10.76%**
	Business-to-Consumer Internet Commerce	
14	**Compound Annual Growth Rate--1999-2011**	**16.05%**
	Total Internet Commerce	
17	**Compound Annual Growth Rate--1999-2011**	**12.49%**

This suggests that the Tennessee numbers regarding the size of e-commerce, already overly inclusive for 2000, are vastly overstated for 2011, at some $6.1 trillion.[21] Before even engaging the thorny issue of the taxable realm of e-commerce, there seems little question now that Internet growth rates simply are not what the Tennessee authors (and, frankly, everyone else) thought they were just three or four years ago.

If states therefore claim there is a policy emergency arising from the growth of e-commerce, the best available growth rate numbers (Census Bureau data from the Department of Commerce) show a very different picture.

[20]This study's use of a linear trend line from the two peak years of Internet growth itself probably overstates the future growth rate of B-to-B Internet usage, as most industry experts expect recent but not yet reported growth rates to be lower.
[21] One striking explanation for the extraordinarily high growth rate for B-to-B commerce in the Forrester projections relied upon by the Tennessee authors was Enron. According to Forrester's November 2001 study of B-to-B E-Commerce, Enron would account for approximately $1 trillion in utility sales on-line, representing about one-fifth of total B-to-B e-commerce in 2006. (Forrester November 2001)

If there is a leak to state treasuries at all, it is growing only incrementally. As one e-commerce expert recently observed, "the idea of incremental change is not a sexy concept that can be hyped at every turn. But most experts likely would agree that low but stable growth rates are better for the economy than the wild highs and lows seen in recent years."[22] They also provide a more reasonable basis for evaluating tax policy.

VI. WHAT PART OF E-COMMERCE MATTERS FOR THE USE TAX?

As the Tennessee authors correctly point out, two issues matter in determining the amount of foregone revenue: the amount of sales exempt from taxation, and the amount of the balance that is remitted. Each of these issues plays out differently for businesses and consumers.

A. Business-to-Business

The Tennessee studies assert that 52 percent of e-commerce B-to-B sales are taxable, and claim 50 percent compliance for use tax remittances for non-vehicle purchases and 100 percent for vehicular purchases, resulting in a weighted compliance rate of 65.2 percent. Though this study makes no change to the proportion of exempt sales, and only moderate adjustments to the compliance figures used in the Tennessee studies, the actual taxable bases are likely smaller, and the compliance rates much higher, for the following reasons:

1. Exempt sales: In defining the relevant universe of taxable B-to-B transactions, it is important to recall the earlier point that a very large proportion of B-to-B shipments are not taxable at all as part of the manufacturing supply chain. Original Equipment Manufacturer (OEM) sales, together with inter-factory shipments within a single company, do not normally qualify as consumable goods, and are generally entitled to the manufacturing exemption from sales tax. B-to-B transactions in which the business is the end user, and thus is subject to sales tax, are likely to be found in the numbers for Internet transactions. This study accepts the Tennessee studies' assumptions regarding the proportion of B-to-B transactions exempt from sales taxes, even though a greater percentage of supply-chain (exempt) sales are likely taking place over the Web than the Tennessee study acknowledges.

2. Compliance rates: The Tennessee studies make poorly substantiated assumptions regarding use tax compliance by businesses engaged in e-commerce. In their 2000 study they write, "use tax compliance is somewhat greater for businesses [than for consumers], but still falls far short of the legislated burdens."[23] Yet as the Tennessee authors acknowledge, "no precise estimates are available on the extent to which use taxes are being paid on B-to-B transactions."[24] Consequently, the methodology by which they arrived at their weighted average of 65 percent compliance for businesses

[22] Quoted in Woods (2003)
[23] Bruce and Fox (2000)
[24] Bruce and Fox (2000) p. 10.

was highly unsystematic. It appears to be based simply on "suggestions" by an unknown number of state revenue officials that the "current average" was about 40 to 50 percent, with compliance higher for vehicle purchases requiring registry.[25]

Yet this highly subjective assumption is at the lowest end of estimates cited in the literature on this issue. It is at variance with the effective 100 percent compliance rate for B-to-B compliance offered by some other state officials cited by the General Accounting Office, and the near 100 percent compliance cited in some expert testimony and academic literature.[26] It also appears to be unsupported by the ratios of voluntary use tax remittances by businesses reported by states.[27] Indeed, no evidence has been offered to show the states experienced an appreciable loss of tax revenues arising from inter-state business-to-business e-commerce transactions during the EDI era.

Given the preponderance of B-to-B sales in current and future e-commerce, a higher compliance rate consistent with the likelihood that businesses will be audited reduces the estimated sales tax loss. Although Cline and Neubig and Goolsby have cited figures of near 100 percent use tax compliance, this paper uses a more conservative weighted average of 85 percent, though even this number in all probability understates the compliance rate.

TABLE 3. Business-to-Business Exempt Sales and Sales Tax Collected, Selected Years. (Various data sources.)

	Description/Year	2001	2006	2011
	Less Exempt B-to-B			
18	% Exempt--Tennessee Estimate	0.40	0.59	0.63
19	Exempt B-to-B Internet Sales--Tennessee Estimate	25.2	67.5	113.8
	Less B-to-B Sales Tax Collected			
20	B-to-B Compliance Rate	0.85	0.85	0.85
21	B-to-B Sales Tax Collected	32.8	40.3	55.9

Although the typical 98 percent of use tax remittances derived from business sources strongly suggests a very high compliance rate, it is only appropriate to acknowledge that solid empirical research on the question of business use tax compliance rates remains to be done. Neither the Tennessee authors nor any other scholars appear to have moved beyond the level of educated guesswork on this issue.

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[25] Bruce and Fox (2000), p. 10. Needless to say, whether state tax officials are disinterested observers on this point is open to question. A statewide "average" compliance rate would overlook the fact that compliance rates almost certainly increase with the size and value of purchases of the business, and the threat of being audited, to which large companies are more exposed.
[26] GAO (2000); Cline and Neubig (1999); Goolsby (1997).
[27] The collection rate on consumer purchases assumed by the University of Tennessee is 19 percent in the base year of 2001. Assuming this to be accurate, it is hard to see how businesses in the states of Maine and Tennessee, whose examples were cited above, could have a compliance rate only three times higher, when they remit about 50 times as much use tax.

Ultimately, however, if the states have reason to believe that businesses are not sufficiently in compliance, they have the authority under the existing definition of nexus to audit them more thoroughly. Indeed, at the end of the day, the question of B-to-B e-commerce and compliance rates may be irrelevant to the question of changing the definition of nexus, since the states currently have all the legal tools they need to make B-to-B use tax remittances comply with the law.

B. Business-to-Consumer

As noted earlier, the main issue in the emergence of the Internet remains B-to-C commerce. Only at the level of the consumer and his or her networked PC, does the Internet really offer a new substitution opportunity for inter-state sales to displace some intra-state sales, with possible negative consequences for state treasuries. Even here, however, the shifts are far less than what the Tennessee studies assume.

1. Exempt Sales: The Tennessee studies were written before it was clear that on-line retail sales were growing most strongly in a limited number of high-visibility niche areas -- many of which are exempt from sales taxes. This study consulted estimates of B-to-C e-commerce trends from Forrester research published subsequent to the Tennessee studies, from which this study estimated differentials in growth rates in various sectors of B-to-C e-commerce.[28] This paper adjusts the exemption upwards by one tenth of one-percent per year to account for this difference.

2. Compliance Rates: While compliance rates for B-to-C e-commerce use tax payments are probably significantly lower than in B-to-B, the compliance rate will probably actually be higher in the years to come than the Tennessee studies believe. The main reason for this is the demise of the pure-play "e-tailer" model in favor of "bricks and clicks" multi-channel marketing.

The misperception of a rush to substitute inter-state sales for instate sales arose for the same reason as the perception of growth in e-commerce generally. There was a failure to ask consumers "if they were going to make a mad dash to the Internet to buy items like dog food, plants, and furniture. As a result, many pure-play e-tailers selling such items ended up on the dot-com scrap heap. Demand simply did not materialize."[29]

Many firms that developed an on-line presence to substitute for their bricks and mortar businesses now find that e-commerce works best as a complement to bricks and mortar retailing. As more and more customers seek to browse and shop online AND pick-up and return merchandise offline, the strict legal wall of separation between dot.com and Main Street businesses must and will change.

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[28] See Forrester (2002).
[29] Woods (2003).

Consequently, many former dot.coms are now collecting use tax, and many more are likely to do so in the years ahead.[30] This trend further reduces the amount of uncollected sales tax caused by the Internet. In as much as the "pure play" model of e-tailing is effectively in decline for all but a select number of highly visible niche companies, the issue of remote sales tax collection will essentially resolve itself as former pure-play e-tailers acquire physical nexus in the states in which they conduct business.

TABLE 4. Business-to-Consumer Exemptions and Collections, Selected Years. ($ Billions)

	Description/Year	2001	2006	2011
	Less Exempt B-to-C			
22	% Exempt--Estimate From Forrester (2000) Projections	0.09	0.15	0.17
23	% Re-estimation From Forrester (2002) Projections	0.14	0.20	0.22
24	Exempt B-to-C Sales--Re-estimation	4.9	15.2	25.8
	Less B-to-C On Which Tax Collected			
25	Base Collection Rate--Tennessee Studies	0.19	0.26	0.28
26	% Increase Arising from Physical Nexus Acquisition	0.01	0.04	0.06
27	Revised Collection Rate	0.20	0.29	0.34
28	B-to-C Sales Tax Collected	6.1	18.0	30.6

VII. WHAT ARE THE IMPLICATIONS FOR THE DEFINITION OF NEXUS?

This paper is not concerned with the economic or legal merits of sales and use taxes per se. It takes for granted that the affected parties should comply with sales and use taxes on the statute books. The question at stake in altering the definition of nexus is thus not, do remote sellers enjoy an unfair legal advantage? but rather, should remote sellers have imposed on them an unfair legal burden? Only evidence of a large and rapidly growing substitution between in-state and out of state trade, and an absence of alternative remedies, should justify such a burden.

[30] Krebs (2003).

TABLE 5. Total Uncollected Sales Taxes, Various Years. ($ Billions.)

	Description/Year	2001	2006	2011
30	Total Potential Untaxed Sales From Internet Commerce	29.9	50.4	70.5
31	Of Which: B-to-B	5.8	7.1	9.9
32	Of Which: B-to-C	24.1	43.3	60.6
33	Average State and Local Sales Tax Rate	0.064		
34	TOTAL POTENTIAL UNCOLLECTED SALES TAX	1.9	3.2	4.5
35	Of Which: B-to-B	0.4	0.5	0.6
36	Of Which: B-to-C	1.5	2.8	3.9

As can be seen from Table 5, calculations based upon Department of Commerce data now indicate that only $1.9 billion may have been uncollected from remote sales in 2001, and that this amount will only reach $4.5 billion in 2011. These figures are 14 percent and 8 percent, respectively, of the $13 billion and $55 billion claimed by the most recent University of Tennessee study for these two years.[31]

Further, under current law, it is wholly within a state's power to audit its in-state businesses for compliance with use tax laws. Thus, if a state had reason to believe that business compliance rates were inadequate, it would be well within its rights to audit such businesses more thoroughly. Given this, the large role of B-to-B e-commerce included in the Tennessee studies may be largely irrelevant to the question of whether changing the definition of nexus is a fiscal necessity for the states.

Even in the realm of B-to-C e-commerce, not only is a large and growing pool of uncollected use tax not in evidence, there are alternative remedies that states can profitably explore. These typically involve raising the awareness of the use tax obligation among state residents, and reducing the difficulties of compliance for them.

One way to do so is to integrate the use tax with the income tax in those states where income tax is levied. As of 1999, at least 15 states and the District of Columbia did so. One academic study on the question of compliance noted that 18,000 residents of Kentucky, for example, voluntarily reported use tax obligations totaling almost $12 million in 1999 when a use-tax line was added to the Kentucky income tax form.[32] This averaged to over $650 per respondent.

The Tennessee studies also fail to recognize that there would be shrinking economic activity from home-state retailers due to imposition of use tax from out-of-state jurisdictions. This shuffling/transfer of resources would be accompanied by a fairly

[31] Bruce and Fox (2001) p. 6
[32] Martie (1999), p. 35.

substantial dead-weight efficiency loss due to the increased administrative burden states would have to incur to enforce compliance nationwide. This study does not calculate this loss, but any full reckoning of the costs and benefits of a changed definition of nexus would properly include this assessment.

As Tennessee study co-author William Fox notes in a different article, the use tax "requires retailers to account for sales made in all market states, distinguish between taxable and exempt transactions and apply the proper tax rate to the transaction....tax administrators may need an auditing presence in virtually all states to ensure the integrity of use tax laws."[33] The Tennessee studies certainly have not undertaken to show that any increased tax neutrality between use-taxed and sales-taxed transactions compensates for this dead-weight loss.

It is also possible that changing the definition of nexus could be a Pandora's box, with unforeseen consequences for domestic and international economic policy. If Paris, Texas, is allowed to tax remote sellers, could Paris, France, be far behind? America's economic trading partners may cite any change to the American definition of nexus as a precedent during future rounds of multi-lateral trading negotiations. As University of Chicago economist Austan Goolsby has observed, "European officials will face a powerful temptation when it comes to taxing Internet commerce. The majority of online merchants are located in the United States. There will be increasing pressure to put special taxes on e-commerce that will disproportionately affect U.S. merchants competing with domestic [i.e., non-U.S.] retailers."[34]

Ultimately, however, the remaining definitional and measurement difficulties involved in estimating the amount of losses suffered by states from e-commerce, argue against precipitous action. Further research into the different effects of the Internet on consumer and business tax behavior should be undertaken to more precisely ascertain the likely future impact of the key variables affecting uncollected sales tax.

[33] Fox and Murray (1997).
[34] Goolsby (2002), p. 12

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NOTES TO POTENTIAL UNCOLLECTED SALES TAX ARISING FROM INTERNET GROWTH

LINE	DATA SOURCE OR FORMULA
	BUSINESS-TO-BUSINESS INTERNET COMMERCE
1	Historical Data for 1999 and 2000 from March, 2002 Dept. of Commerce Census Bureau E-Stats Report. Subsequent years projected from linear trend.
2	Percentage Obtained By Inquiry to Thomas L. Mesenbourg, Director, Bureau of E-Commerce
3	Line 1 X line 2
4	Historical percentage From March 2002 Department of Commerce Census Bureau E-Stats Report. Internet share estimated by author to increase .33% per year
5	Line 4 X line 5
6	Historical Data for 1999 and 2000 from March, 2002 Dept. of Commerce Census Bureau E-Stats Report.Subsequent years projected from linear trend.
7	Historical percentage From March 2002 Department of Commerce Census Bureau E-Stats Report. Internet share estimated by author to increase .5% per year
8	Line 6 X line 7
9	Sum of lines 5 and 8
10	Line 9 X 97.5%, the percentage used by Bruce and Fox (2000) to adjust for share 45 states with sales taxes as percentage of national economy
11	Compound Annual Growth Rate: (2011-1999)^(1/12)-1. Informational Purposes Only.
	BUSINESS-TO-CONSUMER INTERNET COMMERCE
12	Historical Data for Q1 2000 through Q4 2002 from March, 2003 Dept. of Commerce Census Bureau B to C E-Stats Report. 1999 and years 2003 - 2011 projected from linear trend.
13	Line 12 X 97.5%, the percentage used by Bruce and Fox (2000) to adjust for share 45 states with sales taxes as percentage of national economy
14	Compound Annual Growth Rate: (2011-1999)^(1/12)-1. Informational Purposes Only.
	TOTAL INTERNET COMMERCE
15	Sum of lines 9 and 12
16	Sum of lines 10 and 13
17	Compound Annual Growth Rate: (2011-1999)^(1/12)-1. Informational Purposes Only.
	LESS EXEMPT B-TO-B
18	Percentages for 1999 and 2000 derived from Bruce and Fox (2000) estimates. Percentages for 2001 - 2011 derived from Bruce and Fox (2001) estimates.
19	Line 10 X line 18
	LESS B-TO-B SALES TAX COLLECTED
20	B-to-B use tax compliance rate estimated by author. See accompanying text for additional citations.
21	Formula is (line 10 - line 19) X line 20

	LESS EXEMPT B-TO-C
22	Derived from Bruce and Fox estimates (2001), based on Forrester projections for B-to-C E-commerce growth
23	Bruce and Fox rate re-estimated by author in accordance with revised projections for B-to-C e-commerce growth from Forrester (2002). Formula is line 22 (2001) + .05
24	Line 13 X line 23
	LESS B-TO-C ON WHICH TAX COLLECTED
25	Percentages derived from Bruce and Fox (2001) estimations
26	Percentage increase in collection rate due to acquisition of physical nexus arising from normal economic growth. Estimate by author. See accompanying text.
27	Sum of lines 25 and 26
28	Formula is (line 13 - line 24) X line 27
29	Sum of lines 19, 21, 24, 28
	TOTAL POTENTIAL UNTAXED INTERNET COMMERCE
30	Line 16 minus line 29
31	Line 10 minus line 19 minus line 21
32	Line 13 minus line 24 minus line 28
33	6.4% taken from Bruce and Fox (2001). (Note: national average sales tax rate is probably closer to 5.5% or a value for line 33 of 0.055)
	TOTAL POTENTIAL UNCOLLECTED TAX FROM INTERNET COMMERCE
34	Line 30 X line 33
35	Line 31 X line 33
36	Line 32 X line 33

	($ Billions)					Projected								
	Description/Year	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
	Business-to-Business Internet Commerce													
1	Total Manufacturing Shipments--All E-Commerce	729.6	776.9	824.2	871.5	918.8	966.1	1013.4	1060.7	1108	1155.3	1202.6	1249.9	1297.2
2	% Net of Inter-plant	0.88	0.88	0.88	0.88	0.88	0.88	0.88	0.88	0.88	0.88	0.88	0.88	0.88
3	Amount Net of Inter-plant	642.0	683.7	725.3	766.9	808.5	850.2	891.8	933.4	975.0	1016.7	1058.3	1099.9	1141.5
4	% Internet	0.05	0.05	0.05	0.053	0.056	0.059	0.062	0.065	0.068	0.071	0.074	0.077	0.08
5	Manufacturing Shipments--Internet Only	32.1	34.2	36.3	40.6	45.3	50.2	55.3	60.7	66.3	72.2	78.3	84.7	91.3
6	Merchant Wholesale Trade--All E-Commerce	182.5	212.8	243.1	273.4	303.7	334.0	364.3	394.6	424.9	455.2	485.5	515.8	546.1
7	% Internet	0.12	0.12	0.12	0.125	0.13	0.135	0.14	0.145	0.15	0.155	0.16	0.165	0.17
8	Merchant Wholesale Trade-Internet Only	21.9	25.5	29.2	34.2	39.5	45.1	51.0	57.2	63.7	70.6	77.7	85.1	92.8
9	Total B-to-B Internet Commerce--All States	54.0	59.7	65.4	74.8	84.8	95.2	106.3	117.9	130.0	142.7	156.0	169.8	184.2
10	Total B-to-B Internet Commerce--Sales Tax States	52.7	58.2	63.8	73.0	82.6	92.9	103.6	114.9	126.8	139.2	152.1	165.6	179.6
11	Compound Annual Growth Rate--1999-2011	10.76%												
	Business-to-Consumer Internet Commerce													
12	Retail E-Commerce--All States	20.1	28.9	35.9	45.5	53.4	61.8	70.1	78.4	86.7	95.1	103.4	111.7	120.1
13	Retail E-Commerce--Sales Tax States	19.6	28.2	35.0	44.4	52.1	60.2	68.3	76.5	84.6	92.7	100.8	108.9	117.1
14	Compound Annual Growth Rate--1999-2011	16.05%												
	Total Internet Commerce													
15	Total Internet Commerce--All States	74.1	88.6	101.4	120.4	138.2	157.0	176.4	196.3	216.8	237.8	259.4	281.5	304.2
16	Total Internet Commerce--Sales Tax States	72.3	86.4	98.8	117.4	134.7	153.1	172.0	191.4	211.4	231.9	252.9	274.5	296.6
17	Compound Annual Growth Rate--1999-2011	12.49%												
	Less Exempt B-to-B													
18	% Exempt--Tennessee Estimate	0.45	0.43	0.40	0.43	0.47	0.51	0.55	0.59	0.61	0.62	0.63	0.63	0.63
19	Exempt B-to-B Internet Sales--Tennessee Estimate	23.5	25.0	25.2	31.0	38.5	47.7	57.4	67.5	77.4	86.8	95.9	104.9	113.8
	Less B-to-B Sales Tax Collected													
20	B-to-B Compliance Rate	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85
21	B-to-B Sales Tax Collected	24.8	28.3	32.8	35.6	37.5	38.4	39.3	40.3	42.0	44.5	47.7	51.6	55.9

	Less Exempt B-to-C													
22	% Exempt--Estimate From Forrester (2000) Projections			0.09	0.10	0.11	0.12	0.14	0.15	0.16	0.16	0.17	0.17	0.17
23	% Re-estimation From Forrester (2002) Projections			0.14	0.15	0.16	0.17	0.19	0.20	0.21	0.21	0.22	0.22	0.22
24	Exempted B-to-C Sales--Re-estimation			4.9	6.5	8.4	10.4	12.9	15.2	17.6	19.8	21.9	23.9	25.8
	Less B-to-C On Which Tax Collected													
25	Base Collection Rate--Tennessee Studies			0.19	0.20	0.22	0.24	0.24	0.26	0.27	0.27	0.27	0.28	0.28
26	% Increase Arising from Physical Nexus Acquisition			0.01	0.02	0.02	0.03	0.03	0.04	0.04	0.05	0.05	0.06	0.06
27	Revised Collection Rate			0.20	0.22	0.24	0.26	0.27	0.29	0.31	0.32	0.32	0.33	0.34
28	B-to-C Sales Tax Collected			6.1	8.3	10.5	13.1	15.2	18.0	20.5	23.1	25.6	28.1	30.6
29	Total Adjustments			69.0	81.5	94.9	109.5	124.8	141.0	157.5	174.2	191.1	208.5	226.1
	Total Potential Untaxed Internet Commerce													
30	TOTAL POTENTIAL UNTAXED INTERNET SALES			29.9	35.9	39.8	43.6	47.2	50.4	53.9	57.6	61.8	66.0	70.5
31	Of Which: B-to-B			5.8	6.3	6.6	6.8	6.9	7.1	7.4	7.9	8.4	9.1	9.9
32	Of Which: B-to-C			24.1	29.6	33.2	36.8	40.2	43.3	46.5	49.8	53.3	56.9	60.6
33	Average State and Local Sales Tax Rate			0.064										
	Total Potential Uncollected Tax From Internet Commerce													
34	TOTAL POTENTIAL UNCOLLECTED SALES TAX			1.9	2.3	2.5	2.8	3.0	3.2	3.4	3.7	4.0	4.2	4.5
35	Of Which: B-to-B			0.4	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.6	0.6
36	Of Which: B-to-C			1.5	1.9	2.1	2.4	2.6	2.8	3.0	3.2	3.4	3.6	3.9

Mr. CANNON. Our final witness is Jack VanWoerkom, Executive Vice President and General Counsel of Staples, Inc. Headquartered in Framingham, Massachusetts, Staples is a nationally-known retailer with more than 1,100 stores in 45 States and Washington, D.C., and that is in my hometown and district, as well, and we really enjoy Staples marketing and pricing, I might just point out. [Laughter.]

As well as having catalog, Internet, and contract sales operations. Prior to joining Staples in 1999, Mr. VanWoerkom served as General Counsel to Teradyne, Inc., a manufacturer of semiconductor test equipment. He was also a partner with the Boston law firm of Hale and Dorr from 1978 to 1985.

Mr. VanWoerkom earned his undergraduate degree from the Massachusetts Institute of Technology and a law degree—you are going to have to explain that one. I thought most of us lawyers were just dumb guys and we appreciate your technical insights here. [Laughter.]

I shouldn't say that of my fellow lawyers on this Committee.

And he earned his law degree from Boston University School of Law.

Mr. VanWoerkom, thank you for offering your valuable insight today and we look forward to your testimony.

STATEMENT OF JACK VANWOERKOM, EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL, STAPLES, INCORPORATED, FRAMINGHAM, MASSACHUSETTS

Mr. VANWOERKOM. Thank you, Chairman Cannon, Ranking Member Watt, and Members of the Subcommittee, and a special thank you to Mr. Delahunt, our home State Congressman. It is an honor for me to be here today to testify on behalf of Staples and our e-commerce business, Staples.com.

We have been working extensively on this issue for many years. Our founder and Executive Chairman, Tom Stemberg, has been personally active, meeting with Members of Congress and State officials, testifying in other Congressional hearings, addressing the National Conference of State Legislatures, and reaching out to other businesses.

I am pleased to be here today to say that we support the Streamlined Sales and Use Tax Agreement and the legislation that was recently proposed by Congressman Istook and Congressman Delahunt. We support it because it levels the playing field among all retailers by requiring remote retailers to collect and remit State sales taxes in the same manner as brick-and-mortar retailers, and in the same manner as Staples does, because we are both. We are both an online retailer and a brick-and-mortar retailer. We also support it because it simplifies the enormous task of complying with State sales tax, and it is enormous.

But let me start by putting to rest three common misconceptions, and I will be brief about these because I think they have already been touched upon.

Number one, this is not a new tax. This is the collection of an existing tax.

Number two, this is totally voluntary on the part of the States. No State has to participate in this. It is up to the State and its elected officials to decide whether or not to do it, and it is also up to the State to decide what to tax and how much to tax.

And third, collecting sales tax on remote Internet retailers will not harm Internet commerce and will not retard the growth of e-commerce. Solid businesses will be successful. Poor ones will fail. This is not going to be the thing that makes the difference.

Now, to go back to the level playing field, I would like to give you an example from our business as to what I mean by leveling the playing field. We have over 100 stores in New York and we got a call from one of our GMs, a general manager, in a store in Manhattan and he told us the following story. He had a customer come in who was trying to—he is a small business—he was trying to upgrade his computer system. He had three or four computers on a network. He came in. He spent several hours in the store. Our general manager worked with him several hours over several days. It wasn't a question of whether he was going to buy the system but making sure he got the right one.

So he worked with him closely and they got right to the end and they had a technical question. So the customer went back to his office and he called the manufacturer just to get the technical answer to make sure the system was going to work the way he wanted it to. He talked to the manufacturer, explained to him what he was doing, got his answer. The manufacturer then said, and oh, by the way, do you know that we have an online website where you can buy this product that you are looking for and you don't have to pay sales taxes?

Now, this is a $10,000 system. In New York, the sales tax on $10,000 is $900. That is a big deal to a small business. So he bought it from the online retailer, not from us. That is not a level playing field.

We have stores in 45 States and we have made investments in the stores. We provide jobs. Every store provides between 30 and 50 jobs around the area of that store. We pay property taxes. We pay income taxes. We make a significant investment in every one of these States. As a result of that, we bear the burden of collecting and remitting sales taxes and the burden of complying with the sales tax system.

Our competitors who are purely online retailers don't. They don't collect and remit the sales tax and they don't have the burden of complying with that system. Compliance, just filing our returns, making sure we get the right amount and remit the right amount to the right jurisdiction, costs us $4 million a year, just filing of forms. Our competitors don't have that expense. We consider that to be not a level playing field and all we are asking for is the same rules as everyone else plays by.

Now, the other reason that we support this is simplification. As was said here earlier, there are now close to 8,000 different taxing jurisdictions when it comes to sales tax. That means 8,000 returns, 8,000 different systems to understand and comply with. As I said, that costs us $4 million a year.

What this legislation will permit and what it will do is very simple. Through consistent definitions and categories of products, I can essentially have a matrix where on one side I have products, product numbers. The other side, I have zip codes. And all I have got to do is look in there and say, it is this product in that zip code. There is the rate. That is what I charge. That is what I have to remit to the State. What could be simpler? There is software that can do that. It is very straightforward.

If even half of the States adopt this system, it is a great benefit to us. If half the States adopt it, I go from 7,500 jurisdictions that I have to comply with to less than 4,000. That is half the job. To us, that is a great benefit and we think it is a benefit to the States, too, as they will have the opportunity for more revenue.

So the States who have joined the agreement, and it is 40 out of 45 States that have done this, have done a great job of putting together legislation that will work. It will simplify and it will level the playing field.

In the *Quill* case that was referred to earlier, the Court left it up to Congress to decide whether, when, and to what extent States may require out-of-State retailers to collect sales tax on remote purchases. Staples believes that Congress should decide that the answers to those questions are yes, now, and the Simplified Sales and Use Tax. Thank you.

Mr. CANNON. Thank you, Mr. VanWoerkom. I do appreciate your participation.

[The prepared statement of Mr. VanWoerkom follows:]

PREPARED STATEMENT OF JACK VANWOERKOM

Mr. Chairman and Members of the Subcommittee, my name is Jack VanWoerkom. I am the Executive Vice President and General Counsel of Staples, Inc., and I am honored to be here today to testify on behalf of Staples, Inc., the office supplies superstore, and our e-commerce business Staples.com, on the important issue of internet sales tax collection.

Staples has been working extensively on this issue for numerous years. Our founder and Executive Chairman, Tom Stemberg, has been personally active, meeting with Members of Congress and state officials, testifying in previous Congressional hearings, addressing the National Conference of State Legislatures, and reaching out to other businesses.

We are pleased to be here today in support of The Streamlined Sales and Use Tax Agreement, which provides a uniform, simplified method of imposing and collecting sales tax on remote purchases and creates a level playing field among all retailers. We also strongly support H.R. 3184, The Simplified Sales and Use Tax Act, introduced last week by Congressmen Ernest Istook and William Delahunt. We understand Senators Michael Enzi and Byron Dorgan will shortly introduce companion legislation in the Senate. This legislation is critical to end the current inequity whereby Staples.com is required to collect and remit sales taxes because Staples has made a commitment to be present in local communities. Pure internet retailers do not bear the same burden of collecting and remitting sales taxes.

Although now an established part of the American landscape, Staples was founded surprisingly recently—in 1986. Staples now operates stores in 45 states. With the opening of each new superstore, Staples makes a commitment and an investment in the local community. We create jobs for local residents. We support the community through charitable and civic involvement, working extensively on education through the Staples Foundation for Learning program and youth charities through our partnerships with the Boys & Girls Clubs of America. Staples also contributes to the community by paying state and local taxes, including property and corporate income taxes, which in turn fund valuable services throughout the community.

By contrast, pure internet retailers do not invest in local communities. Further, pure internet retailers are afforded the benefits of local community services, such as roads, police and fire protections, and contract and other legal protections. Yet they do not undertake the responsibility of collecting taxes owed and required for these critical state and local services that allow their products to flow efficiently in interstate commerce.

And yet, we are all in the same business—selling products to the American consumer. A sale is a sale no matter how it is made: in store, online, by phone or by mail. If a retailer is required to collect tax on one sale, it is only fair that all retailers are required to collect tax on all sales.

This is the central aspect of this legislation—leveling the playing field among all retailers.

Some basic background will be helpful to better understand our position.

When an American makes a purchase over the internet or through a catalog, she generally owes state and local tax on the purchase. If the internet or catalog retailer has a presence in the customer's state (such as a store or a distribution center), the retailer is required to collect and remit the sales tax. However, retailers without a physical presence in the state are not required to collect the tax. The consumer still owes the state use tax on the purchase. However, this consumer obligation is widely misunderstood and compliance is very low. Therefore, the tax owed to the state often goes uncollected.

This confusing dichotomy in tax collection responsibility is due to a series of Supreme Court rulings, the most recent of which is the Supreme Court case of Quill v. North Dakota. A decade ago in Quill, the Supreme Court determined that states cannot compel remote sellers to collect sales taxes unless the seller has a "substantial nexus" in the state. The court reasoned that state sales tax laws differed so dramatically that such a requirement would be an undue burden on interstate commerce. At the time, the Supreme Court decision was understandable. The myriad of differing product definitions, overlapping taxing jurisdictions and other requirements made compliance for out-of-state retailers (and even in-state retailers) enormously complicated.

Under the current system, there are multiple levels of complexity in tax rates, product definitions, and compliance burdens.

For example, of those states that impose a sales tax, Colorado has the lowest rate in the nation—2.9 percent. But, in addition to the base rate, in seven counties, there is an extra 0.6 percent use tax for the mass transit system, 0.1 percent to support science and cultural centers, and 0.1 percent for the new Broncos football stadium. Those three taxes apply in all of Denver County for instance, but only in part of Broomfield County. There are four other similar taxes that apply to all or part of certain areas in Colorado. Then there are the more than 200 cities, towns and counties that tack on their own sales and use taxes. Finally, the state updates the complete list of all taxes twice a year . . . And that's just one state.

The greatest complexity often exists in the states' differing characteristics of the exact same product, which can result in confusion to consumers and retailers alike. For example, a baseball cap might be considered clothing in one state, but sports accessories or equipment in another state. Or a particular candy bar might be considered food in one state and candy in another.

It is also extremely costly to deal with the differing state tax rates and product definitions. Overall, Staples spends $4 million annually on sales tax collection and compliance. This includes employing over 30 full-time associates to collect and remit sales and use taxes, comply with state tax audits, and handle sales tax exemptions, and software to process the sales tax exemptions. This does not even include the significant expense of hiring outside legal and tax counsel when a complex issue arises.

In an effort to reduce this enormous complexity and level the playing field among retailers, Staples joined many in the business community in urging the states to develop a simplified, uniform method of imposing and collecting sales taxes. We, like many, were skeptical as to whether it could be accomplished; but the states have done an extraordinary job in creating an historic agreement.

In November 2002, 34 states and the District of Columbia approved the Streamlined Sales and Use Tax Agreement; 40 states are now signatories.

Businesses and states have worked together to make compliance relatively simple and reduce the cost and burden of collecting sales taxes.

- *Uniform Definitions:* By providing for uniform product definitions, the Agreement eliminates the current confusion for consumers and retailers resulting from the exact same product being characterized differently by different states. In the baseball cap example above, the Agreement provides for uniform treatment as clothing in all states.
- *State Decision to Tax or Exempt:* States will continue to determine which items are taxable and which are tax exempt. For example, some states, like Utah, tax food, whereas other states, like Massachusetts, do not. The Agreement would not affect this differing treatment.
- *Tax Rates:* States and localities will continue to determine their individual tax rates. The Agreement provides for one general tax rate per state (and a second rate on food and drugs), and a single local rate per jurisdiction—re-

sulting in one rate per zip code. (The locality must still use the same tax base as the state, e.g., if a state decides to exempt clothing, a local jurisdiction may not decide to tax clothing.) By providing for a single tax rate per zip code, a retailer can easily calculate the sales tax rate, needing only to properly code the item and identify the zip code of the purchaser.

- *Additional Simplification Features:* The Agreement also includes uniform audit procedures and a centralized state administration of local sales and use taxes to reduce (to one) the number of business sales tax filings in any state. Further, retailers will not be held liable if state-provided information, such as rates, boundaries, or zip codes, is incorrect.
- *Affordable Software:* Simplification software has been developed that will be available to retailers and will make compliance affordable and easy.
- *Small Business Exemptions:* Important for small business, the proposed legislation to implement the Agreement exempts businesses with less than $5 million in remote sales from collection responsibilities.

States are now working to conform their state tax laws to the Agreement. For the Agreement to become binding on participating states, at least 10 states representing 20 percent of the population must enact legislation substantially complying with the provisions of the Agreement. As of today, 20 states representing more than 30 percent of the population have enacted the Agreement into their state laws. Numerous other states are working on legislation.

In response to the Supreme Court and Congressional encouragement, the states have done the difficult work of reforming and simplifying their sales tax laws. The Supreme Court in Quill all but begged Congress to get involved, when it noted, "Congress is now free to decide whether, when, and to what extent" states may require out-of-state retailers to collect sales taxes on remote purchases. The Supreme Court envisioned a time when its decision should no longer apply and placed the issue squarely in the purview of Congress. That time has come. Congress should now enact the Simplified Sales and Use Tax Act.

Only by enacting the Simplified Sales and Use Tax Act can Congress give full effect to the reforms, allow the states to implement the simplified system, and collect the taxes the states are already owed.

Before concluding, I would like to put to rest two common misconceptions. First, collecting the sales tax already owed on remote purchases is not a new tax. If the remote retailer does not collect the tax, the consumer still owes the state use tax on the purchase.

Second, collecting sales tax on remote purchases is not a tax on the internet, nor will it harm the growth of the internet or the e-commerce marketplace. Solid internet businesses will continue to prosper. Staples.com, our internet business, like many, has thrived in recent years as more consumers use the internet as a convenient method to shop. Ultimately, a good internet business model well-executed will thrive—a poorly conceived and executed model will not succeed simply due to a reduced tax collection responsibility.

In an ironic twist, Staples now owns the Quill Corporation. We bought it six years after its victory in the Supreme Court. But now that we own it, we wish we could simply ask the Supreme Court to reverse the decision. Even though current law benefits Quill, Staples believes all retailers, including Quill, should be on the same level playing field.

Staples urges Congress to enact the Simplified Sales and Use Tax Act. It will result in the simplification of state sales and use tax systems and provide a level playing field for all retailers.

Thank you for the opportunity to testify today.

Mr. CANNON. I am going to shift a little bit and ask questions first. I normally wait until the end to ask questions, but I would like to ask several quick questions, if we could do it quickly. This is really just informational from my point of view.

My understanding, Mr. VanWoerkom, is that in the case of Staples, you guys basically have a nexus with every sales tax State in the country and so your website—you already charge tax on your website, sales tax on your website.

Mr. VANWOERKOM. We charge tax on our website, that is right.

Mr. CANNON. That has got to be a difficulty for you, because——

Mr. VANWOERKOM. As I said, it is a great difficulty. It costs $4 million a year and takes about 30 individuals to do it.

Mr. CANNON. Just two other things. In the first case, in the case of your person who bought the $10,000 system in New York, doesn't New York have a use tax or some kind of business inventory tax that they work aggressively to execute on?

Mr. VANWOERKOM. They do have a use tax. I think aggressive is probably too strong a word in terms of how hard they try to collect it.

Mr. CANNON. We have probably a different view of this. I am offended by the aggressiveness of the State tax commissioners everywhere in America, and I suspect that your former customer, your would-be customer, might have that same problem at some point in time.

But one other question. How are you going to deal with the fact that each of your stores is going to be selling to people and delivering products to various zip codes plus four around the area? Do you see that as a hurdle for you to implement, as opposed to one flat tax for the jurisdiction where the store exists today?

Mr. VANWOERKOM. You know, just like every other online retailer, we do business based on zip codes. If you have ever bought anything over the Internet, you will see that they always ask for your zip code——

Mr. CANNON. Right.

Mr. VANWOERKOM.—and that dictates how we can deliver, how quickly we can deliver. If you——

Mr. CANNON. But would it be simpler for you to translate that into a tax dollar amount on each item, because you are already using zip codes.

Mr. VANWOERKOM. Yes. It is very easy because that is already sort of a fundamental of how we do our business.

Mr. CANNON. Thank you, Mr. VanWoerkom.

Governor Owens, you mentioned that you view this as an attack on federalism, but what you would have here is actually an interstate compact. It would have legislative, judicial, executive functions, but it would not be the Federal Government that performs those functions. Is there not some health in having a—I mean, in other words, is that really a problem with this particular tax?

Governor OWENS. Mr. Chairman, a very good question. My concern about if Congress authorizes States to join together to collect sales taxes on each other, I think instead of having a wide diversity of taxes within our 50 States, instead of having the tax competition that we have today, where low-tax States frequently benefit from higher employment and a stronger business climate than high-tax States, I think what you would be seeing is a move to essentially a unitary system of taxation.

I understand that States have the option of going into the compact. I also understand to some extent States have the ability to define what they want to tax. I also, though, understand that in the reality, that once you have joined the compact, you, in fact, have given up a significant amount of your sovereignty in terms of wanting to change the rules of your State tax system.

Mr. CANNON. Could a State not withdraw from the compact?

Governor OWENS. It could, but in our real world, once you had gone into this compact and once you had started to have increased revenues——

Mr. CANNON. You would essentially have to forego those revenues.

Governor OWENS. You would actually have to forgo——

Mr. CANNON. Because you would have no context for——

Governor OWENS. So I think in the real world, it would be very difficult to pull out of this compact once you have, in fact, chosen to join it.

Mr. CANNON. So the only correcting force on this compact is not the States, although together they could have a process, but it would be an external Congressional oversight.

Governor OWENS. That is correct.

Mr. CANNON. Which this Committee would probably have.

Governor OWENS. Well, it is more power. [Laughter.]

Thank you. Ms. Riehl, I understand your concern with certainty, but I have had this discussion with several of your members. The economy is growing, and as the economy grows, your people sell more and they make more money, assuming they can raise prices or reduce costs, which is becoming increasingly difficult. But at least the growing economy is, generally speaking, good for your industry. It seems to me that historically, and I believe in the future, the Internet is going to be a driving force in growing the economy.

So I wonder why your group is so clear in its opposition. I understand the certainty piece, but——

Ms. RIEHL. Actually, Mr. Chairman, we believe that a healthy retailer, both today and in the future, is going to be multi-channel. The certainty that we are speaking to really has to do with what it requires of us in order to comply with the law as a collector. We are talking about being a collector.

Mr. CANNON. I understand that certainty piece, but what I don't understand is given the growth—I mean, Staples has made a clear determination to be both online and have a retail channel, and your members can do the same kind of thing. But I am wondering if you are not killing the goose in the process that lays the golden egg by hurting the Internet, if you think that this would hurt the Internet, which I do.

Ms. RIEHL. Actually, I think that for a remote seller, there are already in the voluntary agreement wonderful benefits for a voluntary participant. Under a mandatory system, remote sellers would have all of their costs of collection covered, even above and beyond what any traditional seller gets in the 17 States that give compensation, for a period of 4 years. That basically means that there is no burden. If cost is the determinant of burden and if costs are paid for, there is no burden.

Mr. CANNON. But the burden I am wondering about is the burden on the growth of the economy, which is not the same as the burden on each of your individual members in a particular circumstance. I just hope that your organizational—think about this, because I believe that your group has already disproportionately benefitted from the growth in the economy.

But I will stop moralizing and turn the time over to the Ranking Member, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman.

In my opening statement, I intentionally did not position myself in this debate and I think I need to do that for my own benefit and for everybody's benefit.

We have been working on this issue for a long time, and I believe there is a serious problem which needs to be addressed. But when the bill was dropped and my staff approached me about whether I would be a cosponsor, I intentionally said I don't want to cosponsor this particular bill because I think my role in this process is to get to whatever the best legislation we can get to to solve the problem.

What I don't think I can accept, Governor Owens, though, is your notion that there is no problem, or that this is somehow a new tax, or the fear of what might happen in the future should be something that we should be overly consumed with. I mean, States make decisions about how they are going to act just like everybody else does.

I think we have got a problem and we have got to try to address it. Whether this bill is the perfect vehicle for addressing it is an entirely different issue. Let me try to focus on the bill itself and the solution itself.

I think it might have been Mr. Isaacson who expressed concern, or maybe Governor Owens, about privacy issues. How are the privacy issues here any different than any other privacy issues that we have to address in our dealings with the Internet, in even the collection of information that brick-and-mortar retailers have to collect when they do a point-of-sale collection of taxes? Do you see that there is somehow a different privacy issue that is at play here than there is generally, and if so, if I could just get your quick responses to that, and if it is going to be long and protracted, maybe I want to get a written response to it, because I want to get to a couple of other questions that I want to ask you.

Governor or Mr. Isaacson, whichever one.

Mr. ISAACSON. I think there is a difference, Mr. Watt, and I will try to explain it very briefly. First, what you are doing is collecting information that is going to be shared among 40 different State revenue departments, and then in addition to that, being provided to private companies who are the so-called private service providers, and these private service providers, who are the ones who are going to be running the system for the States and for the retailers, also have subcontractors who are going to have access to that information.

There is nothing in the SSTA that monitors who has that information. There is nothing in the SSTA that calls for an independent monitor or auditor of that——

Mr. WATT. So is the response to that not to do it or to put something in the bill that does that? I mean, we write privacy provisions in. We delegate them to the FTC sometimes, I mean, to write regulations. Is the answer not to do this just because you have got some privacy concerns?

Mr. ISAACSON. If we are going to look at that discrete issue, separate from the other issues, then the answer is that we need to go back and what we need to do is have very clear privacy standards.

We need to have independent auditing of those standards. We need to have penalties for breaches of those standards.

Mr. WATT. Okay, that is fine.

Mr. ISAACSON. All of those are missing.

Mr. WATT. I am with you on that. I am not arguing with you on that. I mean, I think what you have identified is a limitation here that needs to be addressed, possibly in this bill. We need to address privacy issues.

Ms. Riehl, you said that, or you acknowledged at the very outset of your testimony that there were remaining imperfections. I would be very interested in knowing what you think the additional imperfections are so that we can, again, try to address those imperfections. That is what this whole process is all about. I want to ask another question, but if you can do that quickly. I may also want a written response from you about what you think those imperfections are.

Ms. RIEHL. They are very few, Mr. Watt. In fact, the Istook-Delahunt legislation addresses some of the remaining issues that need to be incorporated into the streamlined agreement before a mandatory system could take effect, and that includes some sort of specifications on compensation.

I think it has been long held by traditional sellers that we also would like to be compensated. We believe that that is another issue for another day that we will deal with directly with the States on. That is one issue.

I will say another issue that retail is committed to working with the States on is how do you deal with catalog sales that are paid for by a check. That is an issue that is residual. It is unresolved at this point. JCPenney and Sears, two of NRF's biggest members, still have a large, very vibrant catalog business. It is in our best interest to make sure that those kinds of issues are addressed. Those are two examples.

Mr. WATT. Thank you, Mr. Chairman. I yield back.

Mr. CANNON. Thank you, Mr. Watt.

I would like to recognize Mr. Feeney from Florida as being here with us, but I believe the time would go to Mr. Coble, if you are interested in questioning. You are recognized for 5 minutes.

Mr. COBLE. I thank you, Mr. Chairman. Thank you all for being here, folks. I am going to try to beat that red light, so if you all could give me brief, terse answers, I would appreciate it.

Governor, I represent the furniture capital of the world, High Point, North Carolina, as does Mr. Watt, and High Point is the home to many furniture companies that sell in States and internationally. Some of these companies have been forced to defend lawsuits when they are brought by States that want them to collect out-of-State taxes. Defending these lawsuits, as you can well imagine, is a costly operation in an already struggling furniture domestic market.

If the States' SSTA agreement is not approved by the Congress and a simplified standard for collecting sales taxes out of State is not adopted, would you have any suggestions that would at least assuage the difficulty that our furniture companies are experiencing?

Governor OWENS. Mr. Chairman, yes, sir, I would, Mr. Coble. I would suggest that under *Bellas Hess* and *Quill*, obviously, there is the question of nexus, and that is probably what your furniture sellers are running into in terms of——

Mr. COBLE. That is precisely what they are running into.

Governor OWENS. And so it is certainly within the jurisdiction of this Committee under those two Supreme Court cases to, in fact, do a better job of defining nexus.

There are some issues regarding those Supreme Court cases where, in fact, the private sector is being drawn into unnecessary lawsuits where States feel there is a nexus and the furniture maker feels there isn't, and then you have to go to court to prove it. It would be a great opportunity for this Committee to clear that area of confusion up.

Mr. COBLE. Thank you, Governor.

Ms. Riehl, opponents of the Streamlined Sales Tax and Use Agreement have raised concerns that the implementation would tilt the pendulum in favor of the brick-and-mortar retailers and unfairly penalize the Internet sales. Is it your understanding that the SSTA sales made over the Internet and sales made at the physical store would be taxed identically or differently?

Ms. RIEHL. It would be the same.

Mr. COBLE. Have you heard the opponents' concerns about that?

Ms. RIEHL. We have, and really, it has had to go, Mr. Coble, more to the cost of collection, which we have addressed in the Istook-Delahunt legislation.

Mr. COBLE. Okay. Mr. Isaacson and Mr. VanWoerkom—and by the way, thank you all. You are helping me beat that red light.

Mr. Isaacson and Mr. VanWoerkom, let us assume that we approve this agreement and, in turn, authorize States to require out-of-State merchants to collect sales tax on all sales. Is the implementation there to make it go? Are we ready to respond to this?

Mr. ISAACSON. Mr. Coble, I think that is the precise problem that we have. The SSTP doesn't know what the cost of collection is. The SSTP's own pilot project regarding computer software says we don't have it yet. It is not ready to go. The conformity legislation that the States have been considering is not being adopted in conforming fashion, but instead, they are gaming the system. There are these end-runs being made around the legislation by renaming taxes by adding new taxes as part of the conformity process.

Mr. COBLE. All right, let me hear——

Mr. ISAACSON. We are not ready for that.

Mr. COBLE. Thank you, sir. Mr. VanWoerkom?

Mr. VANWOERKOM. You know, I think, with all due respect, I think what Mr. Isaacson is talking about here is at the margins. I think the system can go. It will work and it will be ready.

Mr. COBLE. Mr. Isaacson, revisiting Ms. Riehl's response to my question, do you think the taxes would be identical?

Mr. ISAACSON. Well, the costs of collection are much greater for an out-of-State retailer. If you look at the furniture manufacturer that you were talking about who is already on the margin, can he afford the $4 million of compliance costs that Mr. VanWoerkom is indicating his company is incurring, or the 30 additional employees that are going to be required in order to collect tax for over 7,000 different tax jurisdictions? Those burdens are enormous and the terms of the SSTA do not say that retailers will be provided for all of the costs of collection.

Mr. COBLE. Thank you, folks, and you all have deprived me of the wrath of the Chairman because I beat the red light. [Laughter.]

Mr. CANNON. Very little penalty, by the way.

Mr. WATT. Could I get the gentleman just to yield before he yields back his time, just to clear up one question from Mr. Isaacson.

You testified and said again in response to Mr. Coble's question that local jurisdictions and States are changing the name of taxes. I can't figure out why there would be any incentive to do that. If they can't collect the tax now and we put in place a regime that allows them to collect it, what interest would they have in renaming the tax so that they couldn't collect it again? I don't understand that.

Mr. ISAACSON. I think I can explain it. In order to participate in the SSTA, the uniformity provisions apply not only to taxation imposed on out-of-State retailers, but it applies to the application of your system within the State, as well. So let me use perhaps a humorous example, in reality that has occurred.

Minnesota, in passing conformity legislation, was confronted with the problem that they had a tax on fur that they wanted to maintain even though fur fits into the definition of clothing in Minnesota, which it is my understanding is not taxable in Minnesota. So it would have resulted in fur being removed from the uniform tax base. It is quite simple. What they did was simply to no longer call it a use tax but call it a special fur tax, and no longer do you have uniformity.

In Tennessee, they have a single item tax and what they have done is they have changed the name of that tax, as well, in order to avoid the application of the SSTA to that form of taxation.

So what you have States doing is keeping the disparities that exist in their system, but doing it through this, what I have referred to as gaming the system, by doing end-runs around the uniformity provisions in the SSTA.

Mr. CANNON. The gentleman yields back.

Mr. Delahunt, are you interested in asking questions?

The gentleman is recognized for 5 minutes.

Mr. DELAHUNT. I thank the Chairman. I also thank him for calling this hearing. I am sure it is the beginning of a process. I think a lot of the questions that have been posed, I think the answers have been very informative.

And I have to agree with Mr. VanWoerkom in terms of the complaints that have been articulated, Mr. Isaacson, by yourself. They really are on the margin. You know, fur in Michigan, whether you call it fur or you call it something else, I mean, I think the issues or the problems that *Quill* has presented far exceed the complaints that you registered, and I say that with all due respect. I know where you are coming from and I understand that you have a certain perspective, one that has to be respected and part of the discourse.

Governor, you are a member of the National Association of Governors?

Governor OWENS. Yes, sir. I am a member of the NGA, National Governors Association.

Mr. DELAHUNT. How many governors support the concept and how many governors are opposed?

Governor OWENS. By far, the greatest majority support increasing tax revenues through collecting this tax.

Mr. DELAHUNT. That is Republican and Democratic?

Governor OWENS. Absolutely.

Mr. DELAHUNT. I am glad to hear that that be the case. It is bipartisan in nature. [Laughter.]

Again, I think we would have a disagreement as to whether this is a new tax or whether it is simply an issue of collecting a tax that is due and owing, but because of the Supreme Court decision, is no longer there.

You say the vast majority. Do you have a number out of the 50?

Governor OWENS. Mr. Chairman and Congressman, sometimes it varies. It depends on how specific we get to the issue. But again, the vast majority of governors support the new revenue. What I would suggest, with all due respect, is whether or not it is a new tax, and I understand the two legitimate issues as to whether it is or isn't, without a doubt, it is billions of dollars of new revenue that governors would like to spend and that legislatures would like to spend. So we can almost agree to disagree on whether it is a new tax, but nobody disagrees that there is billions of dollars that are presently in private pockets that will go into governments' pockets if, in fact, Congress acts on this issue.

Mr. DELAHUNT. I dare say that some of your colleagues would prefer to use the term "lost revenue" as opposed to new revenue.

Governor OWENS. Yes, I am sure they would.

Mr. DELAHUNT. But having said that, in your conversation with your colleagues, they are faced with a certain dilemma. Obviously, the economy is hurting and we know that somewhere in the neighborhood of $100 billion in the aggregate represent the collective deficit of the States, and it does come down to a question of cutting or taxing as opposed to lost revenue, at least in my lexicon.

To supplant that lost revenue, aren't States faced with a major dilemma? I mean, are we going to shift the burden to local communities? Are we going to, for example, rather than provide State aid to education, increase the property tax revenue?

Governor OWENS. Congressman, very good question, and I guess I never thought I would be actually uttering these words, but I only wish that the States since 1995 had been as fiscally responsible as Congress, because it is a fact between 1995 and 2001, State spending increased——

Mr. DELAHUNT. You would even have some disagreement over here on this panel. [Laughter.]

Governor OWENS. Yes, but it is a fact that between 1995 and 2001, State spending increased at twice the rate of Federal spending. And so while I understand that the States aren't receiving all the revenue that all the States would like, I would also suggest that State spending has been increasing as a percentage of GNP faster than Federal spending——

Mr. DELAHUNT. But this——

Governor OWENS.—and some of our challenge is of our own making.

Mr. DELAHUNT. Right. But what I am suggesting is some of that—I presume that some of that increased State spending has been an increased allocation for a variety of different reasons, whether it be a more equitable education formula, the money that goes back to the localities. And if that money is not going back, then those localities are going to be forced to lay off fire fighters. They are going to be forced to lay off police officers, emergency responders. Somebody has got to pay. There is no such thing as a free lunch.

What I see is that by eliminating the option that this particular legislation, or the issues that we are talking about, reduce the number of options available to a State realistically in terms of how they secure their revenue. And the legislation that I filed with my colleague from Arkansas, or Alabama, rather, and Mr. Istook, I think recognizes that, and it was endorsed, by the way, by the National Mayors. I mean, they see that problem.

Here we are, Governor, we are talking about homeland security and we are laying off fire fighters and we are laying off emergency responders. We are laying off police. That is, I would suggest, is a national security issue.

The example that Mr. VanWoerkom gives in terms of——

Mr. CANNON. Does the gentleman have a question? The time has run——

Mr. DELAHUNT. I am warming up. I am warming up. [Laughter.]

No, I don't have a question, but I respect the opinion, and if we have a second round of questions, maybe I will have another question.

Mr. CANNON. The gentleman yields back.

The gentleman from Texas, Mr. Carter. Oh, the gentleman from Florida, Mr. Feeney. Would you like to ask questions?

Mr. FEENEY. Yes.

Mr. CANNON. The gentleman is recognized for 5 minutes.

Mr. FEENEY. Thank you, members of the panel, and Mr. Chairman, for having this discussion.

Mr. VanWoerkom, very quickly if you could for me, just two practical concerns I have is that you mentioned in your testimony that each locality and State would continue to keep its own tax rates. That could be upwards of 7,750 different tax rates if we included every municipality and locality within the United States. And in addition to the definitional problem, in the number of items that are included in the State tax code that may or may not be subject to the tax, it seems to me an incredible complexity to comply with.

And secondly, I have the following hypothetical for you, and I do have a question for my friend, Governor Owens, so I hope that you will get to it pretty quick.

Supposing that I live in the Orlando, Florida, area. I have my laptop as I travel to New York. I order an item from an online warehouse, say, in Minnesota. They ship from a factory in Arizona to my mother, who lives in Pennsylvania. How do we guarantee of these national sales tax or these State agreed-upon taxes in that instance? How do you actually guarantee that you are going to treat different taxpayers equally in terms of guaranteeing a 100 percent collection rate?

Mr. VANWOERKOM. Okay. The answer to your first question is that under the new system, the taxes would be organized for purposes of collection by zip code, which, as I said earlier, that is the way we do our business. We deliver by zip code. We organize by zip code. And it would be much simpler than what we have today, which is done by county or by State, and sometimes it is half a county or a quarter of a county and they have different rates. If we can do it by zip code, it is simple. It is just software. It is very easy to do.

In terms of your hypothetical, the way the system would be organized and the way we do it today is it is based on where we deliver. So if you order and have it delivered to your home, that would be the tax rate that we would use.

Mr. FEENEY. Well, and respectfully, you are with a tremendous American corporation. I am a huge supporter of Staples. You obviously have huge incentives for a whole variety of reasons to comply with the tax code. Not everybody that wants to put his or her wares on the Internet is going to have the same integrity that Staples does and not everybody is going to have the same incentives to comply. So I still have huge concerns.

Remember, we are not only talking about tax rates, but we are talking about as many as 50 different definitions of what is taxable, and you compound that with the myriad of zip codes in a country and you don't have quite infinite possibilities about what is taxable at what rate in the country, but you have an awful lot of complex work and it is going to take a pretty significant computer to comply with, one that probably Staples and other major manufacturers could afford, but I am not sure that everybody could.

But I do want to turn to Governor Owens. I last visited you when I went out to Colorado Springs to see the Space Command and it was a beautiful evening and you were very humble when you talked about the problem that States have had in response to Mr. Delahunt, who, I think, ably pointed out that there is a fiscal crisis in many of our States. But what you didn't point out is that States like Colorado and Florida, that have exercised some significant spending restraint, led the nation in job growth. While the national recession has affected Colorado and Florida, we are in a lot better shape than folks in a lot of States. You probably cringe when you hear the word, but I notice in some States where they have had spending restraint problems, they even have recalls for governor. That may be an ugly word for governors, I don't know.

But I would like you to address the incentive question. There are two sets of incentives that I worry about here. Number one, if I am a State, I am going to start exempting everything under the sun in my sales tax code. I am going to want to move toward an income tax code, which already, by the way, is treated unfairly because you get to deduct it from your Federal taxes. So I am going to tax income where I can collect it and I am going to exempt everybody in my State from sales tax, if I can.

And secondly, the incentive to drive Internet companies offshore because of the fact that they will not have the same incentives and the same integrity as Mr. VanWoerkom's company. What do you think about that possibility?

Governor OWENS. Congressman, I think you have raised two very good points and I would agree with both of your concerns. I think the offshore issue is a very, very important issue. I think that while we have some great companies like Staples that have chosen to do business in 45 States and thus have 45 places of business, I mean, you have other companies like Walter Drake in Colorado Springs which has one place of business and it is Colorado, and if we were able to pass this compact and then have Colorado join it, all of a sudden, Walter Drake would be collecting sales taxes for purchasers in 45 or 50 States. There is some significant new cost to be imposed if we, in fact, pass and allow the compact at the Federal level and allow States to join it.

I think the question of overseas movement of Internet sales is a very significant threat. You could go to Mexico very easily. You could go around the world. And certainly then you could try to tie that into compacts, but it gets harder and harder to get to that tax dollar the more we try to tax it.

Mr. CANNON. The gentleman's time has expired. I thank the gentleman. Those were very interesting questions.

We have been joined by the gentleman from Ohio, Mr. Chabot. Did you have anything? The gentleman is recognized for 5 minutes.

Before the gentleman starts, may I just ask—let me poll the Members of Congress. How many would like to have a second round? [Show of hands.]

I thought that Mr. Carter would do that, but I will certainly make some time available for Mr. Bachus if he would like some time.

Mr. Chabot, would you like an additional round?

Mr. CHABOT. I don't need it, but it is up to you, Mr. Chairman.

Mr. CANNON. And Mr. Bachus, would you like to have someone yield to you? Would you like to ask some questions? And Mr. Feeney, would you like a second round?

Mr. FEENEY. I won't be able to make it back. I have got a meeting in the Capitol.

Mr. CANNON. We actually have until 3:30 before we have a vote, and given the interest, I am inclined to just have some time yielded to Mr. Bachus and end the hearing, and then if you have additional questions, we can do those. I have some that I will do in writing and we will go to that point.

Mr. Chabot, did you want to inquire?

Mr. CHABOT. Yes, Mr. Chairman. Thank you.

Mr. CANNON. The gentleman is recognized for 5 minutes.

Mr. CHABOT. Thank you, Mr. Chairman. I want to first apologize to the panel for not being here personally during the course of your testimony. I assure you that I will read, review each of the testimonies that you have submitted in writing to us. I am used to having about two or three meetings at the same time around this place, but during this time, I literally had five meetings that I was bouncing around, and most of them were pretty important, too, so I want to apologize for that.

Let me just ask Mr. Isaacson, if I could, a question here. In your written testimony, you suggest that if Congress decides to create a national system of State taxes by expanding State tax jurisdiction, it should be accompanied by a repeal of the Federal Tax Injunction Act. This would provide taxpayers with access to Federal courts if the State revenue departments violate taxpayers' rights under the Federal law and the Federal Constitution.

Could you please kind of expound upon the reasons for your recommendation in this area, because I think it is pretty significant.

Mr. ISAACSON. I would certainly be glad to, Mr. Chabot.

Mr. CHABOT. Thank you.

Mr. ISAACSON. The Tax Injunction Act was enacted by Congress in recognition of the fact that States should be permitted to administer their tax systems within their own State borders with their own State courts. The proposal that is before you today is to federalize State tax systems and to allow State and local tax obligations to be exported across State boundaries. So you are now going to have companies located in Maine that are going to have tax obligations in California, for example.

As a practitioner in this field, I know the disadvantages that out-of-State companies are in when they have to contend with the administrative proceedings of State revenue departments and then deal with State court proceedings in front of judges who are frequently elected in those States, and you have no political reputation in the State and you are far from the forum.

If the States are asking Congress for Federal legislation, then the Tax Injunction Act should not be a bar to taxpayers being able to go into Federal court to enforce their rights under those Federal laws, as well as to enforce their Federal constitutional rights, which will continue to exist under the Commerce Clause. So the quid pro quo for any expansion of State tax authority should be access to Federal court by taxpayers who are located outside of the taxing State.

Mr. CHABOT. Let me just follow up with one thing. I know this was addressed somewhat, I have been told, prior to my getting here, but let me ask it again if I could of Governor Owens and Mr. Isaacson, about the expansion of State taxing powers and the effect that that might have on competitiveness of U.S.-based e-commerce companies and also the increasing problem that that would have on American jobs and the current competition that we are engaged in around the world.

So if you could both touch—I know you already have to some degree touched on that, but if you could do that for my benefit, I would appreciate it.

Governor OWENS. Congressman, I would be glad to. I am convinced, and I know this is an underlying issue on this issue, that the Internet has led to significant new revenues for virtually all levels of government, that the efficiency and the way that it has increased productivity means that all of us, State, Federal, and local, have, in fact, received new revenues, significant new revenues because of the Internet. I understand that there are some uncollected revenues depending upon how we define it, but I think that the sum of what has happened has benefitted all governments, even within this existing system which doesn't allow us to capture all of the possible revenue.

Having said that, I believe that we need to encourage progress and the usage of the Internet, because from a productivity standpoint and from a personal choice standpoint, it has given us unparalleled benefits as consumers and really as citizens. And so if you start to tax it, I think you are going to get less of it. So that is one of the reasons why I am opposed to either the new tax or the new collection of revenues from the Internet.

Mr. CHABOT. Okay, thank you. And briefly, Mr. Isaacson, anything you would like to add to that?

Mr. ISAACSON. Digital products can be delivered from Krakow, Poland, as easily as they can from New York City to American consumers, and integrated manufacturing, assembly, warehouse facilities in Taiwan can use UPS and FedEx and DHL and deliver products within the same time frame that they can from Memphis, Tennessee.

Congress may be able to legislate and require American companies to collect tax, but they are not going to be able to require foreign companies to do so. So the effect of imposing new tax obligations on interstate commerce in this country will be to favor foreign competitors of American direct marketers to the disadvantage of America's economy and American jobs.

Mr. CHABOT. My time has expired. Thank you very much.

Mr. CANNON. The gentleman yields back.

Mr. Delahunt, did you——

Mr. DELAHUNT. Yes, I move to strike the last word, and I intend to yield my time.

Mr. CANNON. Actually, the gentleman is recognized for 5 minutes. You didn't have to strike the last word here.

Mr. DELAHUNT. Thank you. I just want to make one comment about productivity. We all agree that the Internet has made the American worker more productive, and that is why we recently unanimously from this Committee supported the enactment of a permanent moratorium on access to the Internet. And yet, at the same time, I think, Mr. Isaacson, your example of Taiwan and China could very well be restated as a State in this country which, for all intents and purposes, becomes a warehouse for goods from Taiwan to be distributed elsewhere, a State with no sales tax.

And yes, while we see data indicating that the economy has grown, the reality is, and I think your example, Mr. VanWoerkom, supports that, is that the United States in the past three or 4 years has lost almost three million jobs. So I dare say, think about this in terms of a job bill.

And with that, I will yield to my friend from Alabama, Mr. Bachus.

Mr. BACHUS. Thank you. Let me ask some of the panelists, maybe the representative of the National Retail Association. Recently, I went on and purchased something from Eddie Bauer on the Internet and they did charge me a sales tax, and I have had that happen several times. But I heard Mr. Isaacson say it is almost impossible to do that. How is it that some national companies are charging people when they purchase over the Internet? They are deducting a sales tax.

Ms. RIEHL. Mr. Bachus, in the case of Eddie Bauer, Eddie Bauer has nexus with all 50 States, including Alabama, because there is a store someplace probably in Birmingham or in Montgomery, and that is the reason why it is done and collected.

As Mr. VanWoerkom had mentioned, and as is true for most retailers right now, you are having to do it in your online sales if you have nexus, and there is questionable nexus that exists for some online merchants, which is why Illinois' Attorney General is going after and suing those companies for compliance under whether or not nexus has been established.

We are looking for a solution here that is good for the growth of business over time, so that we can plan our business and grow our business without being limited by pros and cons in the taxing field. That is it.

Mr. BACHUS. Governor Owens, I enjoyed your speech when you came to Alabama recently. Are you here representing the governors, as a representative of the National Governors Association, or just on your own behalf?

Governor OWENS. No, sir, I am not representing the National Governors Association. As we had discussed earlier, most governors are actually on the other side of me on this issue, though I think most Americans would probably be on my side. [Laughter.]

Mr. BACHUS. I would think most Americans are opposed to any tax, I mean, for any reason whatsoever. They would probably be against government. They would probably abolish the State Government and the Federal Government. [Laughter.]

But I think we all agree that probably wouldn't be prudent. [Laughter.]

But having said that——

Mr. DELAHUNT. It depends who is in charge. [Laughter.]

Mr. BACHUS. And I am not sure that they wouldn't have a good argument. [Laughter.]

What percentage of total tax revenue coming into Colorado is sales tax?

Governor OWENS. You know, at the State level, Congressman, it is about 30 percent of our budget.

Mr. BACHUS. In some Southern States, it is 70 percent. I know Alabama, Governor Bob Riley tried to shift that recently and it was voted down, even though he was going to try to shift it to income and property tax, which some people here had proposed as a solution, just don't rely on sales tax. But our Constitution says you submit it to the people and they chose overwhelmingly to keep our sales tax and to continue to raise 70 or 80 percent of our funds with the sales tax, which, whether it is wise or not.

That sales tax in Alabama that is imposed, do you have any reason to believe it is unconstitutional or that it is illegal, the sales tax they have proposed, or our sales tax in Alabama or these other States which have sales tax?

Governor OWENS. No, sir. I certainly believe that a sales tax is constitutional. I think the Alabama experience was probably confused a little bit by the additional $800 million in addition to the shift to income.

Mr. BACHUS. Well, actually, a $692 million deficit, and then $500 million, and I knows the figures are argued. I don't know as a governor. I will tell you that we are under Federal court order on three different things to come up with money. So I believe that if you were the governor of Alabama and Federal courts had ordered you to come up with additional revenue, to comply with Medicaid and to manage those programs, whether you wanted to or not, you would probably have to do that.

But I will say this. The State of Alabama, in defense—I know that Congressman Feeney said that other States have been better about being more efficient, but if you look for what the State of Alabama raises per capita, it is substantially less than the State of Colorado or the State of Florida. So the State Government in Alabama, in defense of it, is getting by on about 60 percent of what the State Government in Colorado or Florida is.

Mr. CANNON. Would the gentleman yield? Can we bring your governor to Utah for a short period of time and see if we can't get our per capita down?

Mr. BACHUS. I am sure that he might be more comfortable in Utah than Alabama. [Laughter.]

Mr. CANNON. Since we collect more taxes, he probably actually is.

Governor OWENS. Congressman, Colorado has the fourth-lowest per capita taxes in the country. I don't know——

Mr. BACHUS. Well, Alabama is the second lowest. Arizona is first and Alabama is second. We are substantially below the number three by about 14 percent.

Mr. CANNON. Do you have any new districts opening up down in Alabama?

Mr. BACHUS. Do we have what?

Mr. CANNON. Any new districts opening up?

Mr. BACHUS. I hope not.

Mr. CANNON. I am just thinking about moving.

Mr. BACHUS. But I would say this. It is a difficult issue and I think the wonderful thing about our democracy is we discuss all of them. We take different opinions and then we try to come to consensus. I agree with Governor Owens on about 99 percent of what he normally, his positions.

Mr. WATT. Would the gentleman yield?

Mr. CANNON. Mr. Delahunt controls the time.

Mr. DELAHUNT. I will yield.

Mr. WATT. I thank the gentleman for yielding. I just wanted to do two things. Number one, I wanted to ask unanimous consent to submit for the record a statement from the National Conference of State Legislators——

Mr. CANNON. Without objection, so ordered.

Mr. WATT.—which apparently indicates that it is not only the governors who are on the opposite side from Governor Owens, it is the State legislators, also.

[The prepared statement of the National Conference of State Legislators follows:]

PREPARED STATEMENT OF THE NATIONAL CONFERENCE OF STATE LEGISLATORS

Introduction

Recently, Governor Bill Owens of Colorado, under the auspices of his new foundation, Center for the New American Century, issued a white paper attempting to answer questions about the Streamlined Sales and Use Tax Agreement. Unfortunately, Governor Owens' white paper, "Nine Problems with Taxing the Internet" is filled with misstatements and misconceptions. It is important for an honest discussion on the issue of remote sales tax collection that the record be set straight on the simplifications adopted by the States in Streamlined Sales and Use Tax Agreement and correct the misconceptions about how the Agreement will effect transactions over the Internet.

In January of 2000, State legislators and Governors in 32 states authorized their states to engage in multistate discussions on potential ways for states to collectively streamline and simplify their sales and use tax systems. The goal was to reduce the burden and costs of collection for all sellers and create a voluntary collection system for remote sellers. Throughout 2000, revenue officials of these 32 states met monthly and produced a set of recommendations for terms of an interstate simplification agreement to achieve the aforementioned goals.

In the 2001 and 2002 legislative sessions, 35 states enacted legislation to join the Streamlined Sales Tax Implementing States (Implementing States) to finalize the terms for an interstate simplified collection agreement. The Implementing States comprised of legislators, revenue department officials, governors' staff, local government officials and private sector representatives over the course of eleven months and nine meetings reached consensus on the provisions of an interstate agreement. On November 12, 2002 in Chicago, Illinois the delegates of the Implementing States unanimously ratified the comprehensive Streamlined Sales and Use Tax Agreement.

The Agreement substantially simplifies state and local sales tax systems, removes the burdens to interstate commerce that were of concern to the Supreme Court in two previous decisions, *Bellas Hess* and *Quill*, and protects state sovereignty. In addition, the agreement "levels the playing field" between main-street and out-of-state merchants and benefits all retailers by reducing their administrative costs. (Five additional states joined the Implementing States in 2003: California, Hawaii, New York, Massachusetts and Mississippi.)

As of July 2003, 20 states, representing over 30 percent of the total population of the United States, have enacted legislation to reform their sales tax administration in accordance with provisions of the Streamlined Sales and Use Tax Agreement. The states that have enacted legislation to implement provisions of the Agreement are:

Arkansas	Iowa	Indiana	Kansas	Kentucky
Minnesota	Nebraska	Nevada	North Carolina	North Dakota
Ohio	Oklahoma	South Dakota	Tennessee	Texas
Utah	Vermont	Washington	West Virginia	Wyoming

It is our hope that the agreement will serve as the basis for Congress to grant authority to states to require all sellers, regardless of location, to collect sales and use taxes. <u>The Streamlined Sales and Use Tax Interstate Agreement provides the states with a blueprint to create a simplified sales and use tax collection system that when implemented, provides justification for Congress to allow states to request remote sellers to collect sales taxes as was intended in the *Quill* decision.</u>

The Straight Answers to Governor Owens Nine Questions

I. Is the Streamlined Sales and Use Tax Agreement (Agreement)* Revenue Neutral?

Yes, if a state so decides. Each state legislature has the authority or the sovereignty to make their participation with the Streamlined Sales Tax Agreement revenue neutral.

II. Will the Agreement simplify tax compliance for America's merchants as its proponents suggest?

Yes, even if the states did nothing more than adopt the proposed administrative changes contained in the Agreement, all vendors would enjoy reduced compliance complexity. Under the Agreement all merchants would be held harmless for any miscalculations.

II. Does the Agreement pose threats to consumer privacy?

No, the Agreement provides that a certified service provider "shall perform its tax calculation, remittance, and reporting functions without retaining the personally identifiable information of consumers."

II. Will the Agreement require your state and its local jurisdictions to forfeit sovereignty over tax policy in your state?

No, compliance to the Agreement is always optional for a state. The decision to comply with the provisions of the Agreement can only be made by each state legislature and governor-and they can withdraw at any time.

II. Is the Agreement consistent with the Constitutional doctrine of federalism?

Yes, the Agreement is voluntary for states and for merchants. This is not a mandatory compact or violation of the Commerce Clause of the Constitution.

II. Will the Agreement reduce tax policy competition between states?

No, the state legislature in each state that complies with the Agreement will still decide what is taxed, who is exempt and at what rate it wants to tax transactions.

II. Will the Agreement impede the success of the technology revolution?

No, the Agreement provides for technology that will not add any additional forms for the online buyer to complete. The information the buyer provides for the delivery or payment of the product is sufficient to determine the correct sales tax.

II. Will the Agreement hurt certain citizens more than others?

No, all buyers in a state that complies with the Agreement will pay the same sales tax on a transaction regardless if it occurs in a brick and mortar store or online.

II. Will the Agreement really promote equity between brick-and-mortar and online retailers?

Yes, all transactions regardless of the way they are purchased will be treated the same under the Agreement and all retailers will receive reasonable and adequate compensation to cover the costs of collection.

** Governor Owens white paper, "Nine Problems with the Taxing the Internet" mistakenly refers to the Streamlined Sales Tax Project (SSTP). The correct term is the Streamlined Sales and Use Tax Agreement (Agreement). This paper will use the correct term for the Agreement.*

I. Is the Agreement revenue neutral?

Governor Owens' White Paper:

"No. SSTP will increase the tax burden on most American consumers..States that currently exempt certain goods from taxation could be forced to extend sales taxes to currently untaxed products...Those states that do not currently reimburse instate merchants for their costs of collection will be mandated to pay a uniform reimbursement rate for all merchants, whether in state or out of state."

Streamlined Sales and Use Tax Agreement:

Each state legislature has the authority or the **sovereignty** to make their participation with the Agreement revenue neutral if they choose by lowering sales tax rates or by reducing other taxes such as property and/or income. The Agreement is only a blueprint to allow for the collection of sales taxes that are legally levied but presently uncollected, it is not designed to decide policy issues such as what is taxed, tax rates or even revenue neutrality for each state. The Agreement only requires that if a state chooses to tax a product they used the uniform definitions contained in the Agreement.

The white paper is correct in that some states presently do not compensate sellers for collecting sales taxes. This is one of the choices state legislatures have to make in considering their participation in the Agreement. However, states that comply with the Agreement will have the option to cover the costs for compensation out of the revenues collected from remote sales, another form of revenue neutrality. Most state legislators believe it is only fair to compensate vendors for collecting states' sales taxes.

II. Will the Agreement simplify tax compliance for America's merchants, as its proponents suggest?

Governor Owens' White Paper:

"No...SSTP foists national sales tax collection obligations upon each merchant in America...Merchants will even be responsible for determining each customer's nine-digit zip code...If an auditor concludes the merchant undercollected a state or local government's due share, the merchant will have two options-pay the difference or pay a lawyer to litigate."

Streamlined Sales and Use Tax Agreement:

Even if states did nothing more than adopt the proposed administrative changes contained in the Streamlined Sales and Use Tax Agreement, all vendors would enjoy reduced complexity. Governor Owens contends that rates are the biggest complication, but even Robert Comfort, Vice President for Tax Policy, Amazon.com told a congressional hearing in 2001, "...rates are not a problem for Amazon.com." Sellers have testified over and over that the real burdens with collection are not sales tax rates but the different product definitions from state to state, different state and local tax bases and the different rules and administrative procedures for registering, collecting, filing and remittance of sales taxes.

Under the Agreement, the certified technology calculates the sales tax to be collected not the merchant. The merchant does not need to determine the zip code. When the consumer is making a remote purchase, information such as zip code is obtained when the consumer fills in the delivery address. The certified technology that will be used by the merchant determines the sales tax, if any, on a purchase from the delivery address submitted by the consumer. **When the Agreement is operational, all merchants that collect sales taxes using the state certified technology would be held harmless for any miscalculations. The state assumes the liability from the merchant, who under the current collection system bears total liability.**

In the example cited in Governor Owens' White Paper, the merchant would only be held liable for undercollection, if the merchant tampered with the certified technology or fraudulently failed to remit the sales taxes collected.

III. Does the Agreement pose threats to consumer privacy?

Governor Owens' White Paper:

"Yes...the software would calculate the tax due and remit the tax to the destination state and locality...the collection agent would gain access to information about individual consumers and what they purchase...the disparate and often confusing laws of 50 different states...supercede any SSTP (privacy) "precept"...Will her personal information and purchase choices be protected under Colorado law, where she lives, or under the law of the state where her vendor operates?'

Streamlined Sales and Use Tax Agreement:

The Streamlined Sales and Use Tax Agreement has strong provisions that will protect the privacy of all consumers. The Agreement provides that a certified service provider "shall perform its tax calculation, remittance, and reporting functions without retaining the personally identifiable information of consumers." The only time that a certified service provider is allowed to retain personally identifiable information is if the buyer claims an exemption from taxation.

The Agreement requires the certified service providers to retain less information than is currently captured by VISA, MasterCard, American Express, Discover, or any other credit card company when a consumer makes a purchase and these companies can use this information for marketing purposes. If certified providers use or sell any information gathered from calculating sales taxes, they would lose certification to be a collector.

Let's set the record straight: the only information maintained by the vendor or third party collector for sales tax calculation are product, price, zip code, and sales tax collected. Unless the woman that is mentioned in Governor Owens' example is the only person living in the zip code, no one would know who she is!

IV. Will Agreement require your state and its local jurisdictions to forfeit sovereignty over tax policy in your state?

Governor Owens' White Paper:

"Yes...tax policy would be ceded to and dictated by a board of unelected and unaccountable out-of-state tax bureaucrats...SSTP require each state to submit its sales tax system to oversight of a "governing board"...will be vested with administrative, legislative and judicial powers over each participating state's tax policy...it can amend the SSTP with 60 days notice...altering each state's tax laws."

Streamlined Sales and Use Tax Agreement:

No, the Streamlined Sales and Use Tax Agreement does not force any state to forfeit its sovereignty. Compliance to the Agreement is always optional for a state. The decision to comply with the Agreement can only be made by the state legislature and governor-and they can withdraw at any time.

Each state that complies with the Agreement will have one vote on the Governing Board of the Agreement. Each state that complies with the Agreement can have a delegation of up to four people with the state legislature in each state deciding who represents the state. In many cases state legislators and tax administrators have been designated to serve on the Governing Board. The Agreement protects the sovereignty of each state to decide who represents them.

Governor Owens fails to mention that the 60-day notice on amendments must go to the governor and the legislative leaders of each member state; the same governor and legislative leaders who have appointed the delegates to the Governing Board. Governor Owens also fails to mention that an amendment can not change or alter a "state's tax laws." Only the state legislature and the governor have that authority and nothing in the Agreement abrogates that authority.

V. Is the Agreement consistent with the Constitutional doctrine of federalism?

Governor Owens' White Paper:

"No…SSTP would allow participating states to reach across state lines and foist their tax and regulatory burdens upon out-of-state businesses and citizens conducting business on the Internet…Businesses…would be subject to the SSTP's scheme even if their home state democratically chooses not to join the uniform tax regime."

Streamlined Sales and Use Tax Agreement:

Yes. The Streamlined Sales and Use Tax Agreement does not in anyway violate the Constitution and is actually a vibrant example of federalism. The Agreement is voluntary for states and for merchants, this is not a mandatory compact or violation of the Commerce Clause of the Constitution. The states voluntarily participated in the process to formulate the Streamlined Sales and Use Tax Agreement by enacting legislation by the people's elected representatives in each state, signed by the governor. The Agreement ratified by the states' delegates responds to the challenges raised by the Supreme Court in two decisions, *Belles Hess* and *Quill*, and provides a blueprint for Congress to overturn the decision.

Should Congress grant states remote sales tax collection authority if they comply with the Agreement than businesses that are located in a state that *"democratically chooses not to join the uniform tax scheme,"* would only be subject to collection requirements under the Agreement if that seller chooses to sell into a state that "democratically" decided to be party to the Agreement. The Governor exclaims fear that *"This implicates profound practical and theoretical federalism concerns."* However, no seller is forced to sell into states that comply with the Agreement. Out-of-state sellers make that decision and in doing so they also make themselves liable to the other state's non-sales taxes statutes and regulations protecting consumers and conducting business. An insurance company domiciled in Illinois must follow Colorado's insurance laws when doing business in Colorado, the same for banks and many other interstate businesses.

VI. Will the Agreement reduce tax policy competition between states?

Governor Owens' White Paper:

"Yes. The SSTP rewards the least competitive states by allowing them to "dumb down" the tax code…the SSTP effectively undermines the notion of states as "laboratories of democracy"…it allows 10 participating states to piggy-back on the economic investments of 40 other states. It attempts to coerce all states into following minority policy - a virtual "tax cartel."

Streamlined Sales and Use Tax Agreement:

No. As has been stated many times, the state legislature in each state that complies with the Streamlined Sales and Use Tax Agreement will still decide what is taxed, who is exempt and at what rate it wants to tax transactions. How is tax competition "dumb downed" by simplified administrative efficiency or even uniform product definitions? In fact, the competitive strength of America's businesses would be enhanced by reducing the regulatory complexity, costs and burden of the current state sales tax collection system on businesses? Who could oppose reducing or eliminating governmental burden and costs?

The Streamlined Sales and Use Tax Agreement is a prime example of states as "laboratories of democracy." States working together have developed a solution to ensure the viability of a major revenue stream while eliminating the burden, complexity and cost on retailers to collect the states' sales taxes and maintaining state sovereignty for tax policy. State legislators and governors are finding ways to maintain vital government services such as education, health care, public safety and homeland security while ensuring the viability of America's businesses in a global marketplace.

If Governor Owens or his staff has attended the deliberations of the Streamlined Sales Tax Implementing States, they would understand that the Agreement is not the work of a small group of states trying to coerce concessions from the other economically competitive states. First, the Agreement was developed and ratified by representatives from 35 states with very different tax collection systems. In most cases, the Agreement's provisions represent the collection practice of a majority of the sales tax states. Second, there is no mandatory collection authority unless Congress gives its consent and that will not happen if it appeared that this was an effort by a handful of "non-competitive" states wanting to "piggy-back on the economic investments of 40 other states." Finally, as of July 8, 2003, 20 states representing over 30 percent of the population have enacted legislation to comply with the Streamlined Sales and Use Tax Agreement. At least three additional state legislatures are planning to enact the compliance legislation before the end of this year.

VII. Will the Agreement impede the success of the technology revolution?

Governor Owens' White Paper:

"Yes. Attaching tax burdens to each online transaction will dampen enthusiasm for Internet usage and stifle technological innovation. Some people will …log off rather than fill out the requisite tax form…even more troubling is that the proponents of a new national sales tax on the Internet are busily working to craft a policy for imposing state and local taxes on…digital goods…software delivered electronically and uploaded on one's computer…the growth of the digital economy, and the family-sustaining jobs spawned by it, could be placed in jeopardy."

Streamlined Sales and Use Tax Agreement:

Under the Streamlined Sales and Use Tax Agreement, the buyer making a transaction will not need to fill out any additional forms in order for the sales tax to be calculated or collected. The tax is determined by the delivery address, and anyone who is buying a tangible product online wants to make sure that the product is delivered to the right address. The consumer fills out only one address field. In cases of digital products like online books or movies, the online seller wants to be paid and they will not accept a credit card payment without address verification. Once again, no additional tax form would be required.

A study released by Jupiter Research in January 2003 *"Sales Tax Avoidance Is Imperative to Few Online Retailers and Ultimately Futile for All"* found most people are unaware that they are not paying sales taxes when they make a purchase over the Internet. In the same study by Jupiter, only 4 percent of online buyers said that the collection of sales and use taxes would always affect their decision to buy online.

The effort to streamline sales tax collection is not a new tax on electronic commerce. Online sellers already collect sales taxes where they have nexus. The effort of states to streamline sales tax collection will only remove the burden from all sellers in collecting a tax already levied by state and local governments.

Those who oppose applying sales taxes to purchase of digital goods such as books, movies and magazines are, no doubt inadvertently, arguing in favor of keeping pornography tax-free. The access to online pornography has and continues to be one of the largest sellers among digital products downloaded, most if not all currently sales tax free. The Agreement treats the sales of products the same, regardless of the medium that one obtains access. If a state taxes the purchase of an adult or x-rated magazine in the real world, why should the same magazine downloaded or delivered electronically not be taxed?

VIII. Will the Agreement hurt certain citizens more than others?

Governor Owens' White Paper:

"Yes. New on-line transaction taxes will disproportionately punish rural, disabled or even elderly buyers…SSTP will therefore have the effect of widening the so-called 'digital divide.'"

Streamlined Sales and Use Tax Agreement:

If brick and mortar stores are not as accessible in rural areas as they were ten years ago, perhaps they no longer can afford to compete with the price advantage enjoyed by online/remote sellers that do not collect sales taxes. When brick and mortar stores in rural areas are forced out of business that means the rural farmer will have to pay higher property taxes on his farm or increased state income taxes. Higher property or income taxes, just so that one can buy a book or CD on-line sales tax free?

Governor Owens implies that the streamlined sales tax effort will *"have the effect of widening the so-called "digital divide."* Unfortunately he fails to show an equal concern for those hard working Americans who may lack the credit or the ability to shop on line because of a lack of access to the Internet or even a computer. These Americans are paying the sales tax every time they make a purchase in a local brick and mortar store. However, those consumers who have sufficient credit, home computers and access to the Internet are able to avoid the sales tax with almost every online purchase.

IX. Will the Agreement really promote equity between brick-and-mortar and online retailers?

Governor Owens White Paper:

"No... What about compliance costs...compliance costs would put on-line merchants at a competitive disadvantage...on-line merchants are not eligible for the many benefits governments sometimes offer traditional retailers."

Streamlined Sales and Use Tax Agreement:

As was stated previously, the Streamlined Sales and Use Tax Agreement requires states to compensate merchants for compliance. However Governor Owens' White Paper contradicts itself. Earlier in the White Paper, Governor Owens states, *"Those states that do not currently reimburse in-state merchants for their costs of collectio n will be mandated to pay a uniform reimbursement rate for all merchants, whether in state or out-of-state."* Now he writes those online merchants will be disadvantaged compared to brick and mortar sellers because of compliance costs.

Governor Owens' white paper ignores the fact that the online merchant does not pay the sales tax; rather the merchant merely collects the sales tax from the buyer and remits it to the state where the buyer resides or to where the purchase is being delivered and used. The online seller receives all the *"many benefits governments sometimes offer traditional retailer"* in the state(s) they are located.

Conclusion

Governor Owens White Paper concludes with "*...the headlong rush to accomplish this sea change in American tax policy, often without a detailed public debate and the outside glare of media and taxpayer scrutiny must be slowed. Significant questions - including the nine asked here - must be faced, discussed and adequately answered...*"

For the last five years, there have been numerous debates, study projects, joint private and public projects, federal commissions, congressional hearings, and three separate actions by state legislatures and governors to have their states involved in multistate discussions to streamline the states' sales and use tax systems. For most states that have complied with the Agreement, it is at least the second time that the state legislature has had to pass legislation with the intent to simplify their sales tax collection system and for most of those states it was likely the third time. If you add all the efforts back to the first Supreme Court decision in 1967 (*Bellas Hess*) it has been almost a lifetime of public debate.

So far twenty state legislatures and twenty governors asked and agreed with the answers contained in this response to the questions posed by Governor Owens white paper in enacting legislation to bring their states into compliance with the Streamlined Sales and Use Tax Agreement. Of the remaining 45 states and the District of Columbia that have a sales and use tax all but one, Colorado, have expressed some intent to simplify their sales and use tax collection systems. In 2003 even three of the five non-sales tax state legislatures saw the introduction of the Streamlined Sales and Use Tax Agreement (Alaska, Montana, and Oregon).

The Streamlined Sales and Use Tax Agreement is a significant attempt to modernize sales and use tax systems and to save this tax on consumption as a viable component in state revenue mixes. The Agreement substantially simplifies state and local sales tax system, removes the burdens to interstate commerce that were of concern to the Supreme Court, and protects state sovereignty. In addition, the Agreement "levels the playing field" between local and out-of-state merchants and benefits all retailers by ensuring that all transactions no matter through what medium they may take place, will be treated identically.

The Agreement and the effort to obtain Congress' approval to give states that comply with the Agreement the authority to require all sellers to collect sales and use taxes is supported by many retailers and business organizations. A partial list of private sector supporters include:

Alabama Retail Association
American Booksellers Association
American Jewelers Association
Ames Department Stores
Atlantic Independent Booksellers Association
CBL & Associates Properties, Inc.
Circuit City Stores, Inc.
Electronic Commerce Association
First Washington Realty Trust, Inc.
Florida Institute of Certified Public Accountants
Florida Retail Federation
Gateway Companies, Inc.
General Growth Properties, Inc.
Georgia Retail Association
Great Lakes Booksellers Association
Home Depot
Illinois Retail Merchants Association
International Council of Shopping Centers (ICSC)
International Mass Retail Association
(IMRA)
Kentucky Retail Association
Kimco Realty Corporation
K-Mart Corporation
Lowe's Companies, Inc.
Michigan Retailers Association
Mid-South Booksellers Association
Missouri Retailers Association
Mountains & Plains Booksellers Association
National Association of College Stores
National Association of Convenience Stores
National Association of Industrial and Office Properties (NAIOP)
National Association of Real Estate Investment Trusts (NAREIT)
National Association of Realtors (NAR)

National Community Pharmacists Association
National Retail Federation
New England Booksellers Association
North American Retail Dealers Association (NARDA)
Northern California Independent Booksellers
Pacific Northwest Booksellers Association
Performance Warehouse Association
PETsMART, Inc
RadioShack Corporation
Regency Realty Corporation
Retailers Association of Massachusetts (RAM)
ShopKo
Simon Property Group
Southeast Booksellers Association
Southern California Booksellers Association
South Carolina Merchants Association
Staples, Inc.
Target, Inc.
Taubman Centers, Inc.
The Gap, Inc.
The Macerich Company
The Musicland Group, Inc.
The Real Estate Roundtable (RER)
The Rouse Company
Variety Wholesalers
VerticalNet, Inc.
Virginia Retail Merchants Association
Wal-Mart
Weingarten Realty Investors
Westfield America, Inc.

Mr. WATT. And number two, I wanted to just tick off the four concrete things that I have heard that I would like to undertake to work on about this bill and then invite the panelists, if they want to add to the list in writing, to do so.

I heard compensation for collection, which Ms. Riehl talked about; catalog sales paid for by check, which Ms. Riehl talked about; the possibility of access to the Federal courts as a quid pro quo, which Mr. Isaacson talked about; and certainly the privacy issue which might ought to be addressed in the bill, which Governor Owens and Mr. Isaacson talked about.

What I wanted to do was invite you all as witnesses to, if there is an additional thing—don't give me your philosophy about whether a bill is needed. I think I am beyond that. I think we have got a problem. We need to try to solve it, but we need the best bill we can, and if this bill has shortcomings, we need to know what those shortcomings are.

I will yield back to Mr. Delahunt.

Mr. CANNON. Would the gentleman yield? Thank you.

I would like to point out that NCSL is not all legislators and, in fact, represents some that others probably are not with NCSL but rather with Mr. Owens on this issue.

Just one question, Mr. Owens, for you. You have done a lot of tax cutting in Colorado. Have you considered or do you have a use tax and have you considered getting rid of that, since I think it is the most hateful tax on earth? It makes guilty people out of all of us that have it in our States.

Governor OWENS. Mr. Chairman, Colorado in 1992 put in place a constitutional requirement that any new taxes go to a vote of the people, and because of that, we have had a very conservative record of taxing over the last 12 years. We are the fourth-lowest tax State in the country. And so I don't believe there has been much discussion in terms of doing away with the use tax, but I do understand your concern.

Mr. CANNON. I hope that picks up some momentum somewhere.

Mr. Isaacson, the SSTA adopts a destination-based sales tax system. Can you talk a little bit about the advantages or disadvantages of that system?

Mr. ISAACSON. It creates tremendous problems, especially for catalog shoppers. If you take an example of a, for example, a generous grandmother in the State of Utah who wants to send Christmas gifts to children in four different States, it means that she needs to determine the tax rates in all four of those different States. She needs to determine what the exemptions are, because in some States there may be food or clothing which are exempt and others where it is not. There are local taxes in those States, and so she has to determine what the local taxes are.

Mr. CANNON. Well, let me ask you, just as a permutation of that, suppose she goes into a local florist and she has four children around the State that she wants to send something to. What is the burden on that local florist?

Mr. ISAACSON. The ease that is associated with a point-of-sale retailer is that the tax is being collected across the counter, and that is where the major difference comes between the in-State retailer and the out-of-State tax collector, who has to determine and comply with the laws of all of these different jurisdictions.

The consumer is severely disadvantaged by a system that says that they need to self-compute the tax when they are filling out their catalog order form and when they are filling out—when they are making out their check. It becomes an almost insurmountable task for a catalog shopper to comply with that kind of system.

Mr. CANNON. Just one other question. How do the expansion of State taxing powers affect the competitiveness of U.S.-based e-commerce companies and the increasing problem of American jobs being lost to foreign competition?

Mr. ISAACSON. I think it is inevitable and responded to Mr. Chabot accordingly, that the effect especially on digital commerce would be that businesses would flow overseas. You know, the Commerce Clause has been the principal engine of economic development in this country for 200 years before Europe created a common market. And the effect of creating this kind of balkanization of the American tax system, I think would have the inevitable effect of driving American direct marketers and foreign direct marketers to be taking American jobs overseas.

Mr. CANNON. Thank you. The gentleman's time——

Mr. DELAHUNT. I would just like to have one more minute, and I want to address this request specifically to Ms. Riehl to add to the list of items in terms of homework that Mr. Watt has already requested.

What I would be interested in is, clearly, there are a number of small mom-and-pop retail operations, brick-and-mortar, that are working on the margins. Mr. Isaacson talks about direct marketers. I dare say that there is a much larger number of, again, small businesses in our local communities that sponsor the Little League team, that are involved in school programs on a regular basis, that really, if you will, are part of the fabric of our community. Have there been surveys, some sort of empirical data that indicate the impact on them and what does that mean in terms of the economy, the local economies, and clearly one talks about another traditional source of revenue for localities, which is the property tax. What kind of an impact has that had?

Ms. RIEHL. Small businesses are also represented by the National Retail Federation to many hundreds. We have an Independent Stores Board, which I can say is as vocal or more vocal than our large multi-State sellers in pushing for simplifications. A sole proprietorship in any State, and I dare say that a sole proprietorship in the State of Colorado is probably worse off than in any other State because of how complex Colorado is in its tax collection system. Nonetheless, that sole proprietorship spends days each month just complying with the local forums and with the remittance responsibilities.

The simplifications in the Streamline Agreement would automatically reduce to hours, if not days, of compliance. It gives the option to a small seller to outsource that responsibility altogether, and if Congress, in fact, does act, they would probably fall below a de minimis for any remote sales they do outside their State unless they exceeded $5 million in remote sales. So there are advantages, and believe me that there are members of National Retail Federation that are vocally in support on a small business scale.

Mr. CANNON. The gentleman's time has expired.

One of the issues we didn't deal with very much was this $5 million exemption. I am surprised—I was astounded at the number, for instance, of companies that are going to be over $5 million that do business on eBay, so that is an issue that I think we probably need to look at again in the future.

One other point that was intriguing today was the issue of privacy. This Committee probably has the biggest grief or the most jurisdiction on the issue of privacy of any Committee in Congress, and that is one that we care about a lot. My chief of staff just flew out from Utah to Washington, and to see what would happen, he bought his ticket with cash, and you might just guess what happened. I mean, he was given the—he was taken directly from the ticket line into security. I think he expected that. I think he went to the ATM and got the cash just to see what would happen.

But we have a series of problems that are emerging and they relate to privacy, because you are doing a significant—if nothing else, by going zip code plus four, you are requiring people in America to produce a great deal more information. That is an issue that I expect we are going to pursue in the future.

But I want to thank the panel for being here today. We appreciate your comments. They have been very enlightening. I think that the issue is now going to join. I think that after this hearing, the number of people on both sides of the issue are going to come out and start organizing, start moving the issue. We appreciate your willingness to be here today and help frame it at its inception.

Thank you again, and the Committee is adjourned.

[Whereupon, at 3:40 p.m., the Subcommittee was adjourned.]

APPENDIX

Material Submitted for the Hearing Record

QUESTIONS FOR ALL PANELISTS

- What privacy issues or concerns exist under the proposed Streamlined Sales Tax Agreement (SSTA) that do not exist for other types of remote sales?
    - What role does Congress have in ensuring that the agreement includes privacy standards, auditing provisions and penalties for breach?
    - If the States fail to include privacy standards in the agreement, should Congress refuse to sanction the SSTA? Explain the rationale.
- What is the status of the SSTA certified software?
- There was testimony that the SSTA would increase offshore incorporation to avoid taxes. Is this a valid concern?
- Is there or should there be a basis for providing access to the federal courts under the SSTA or H.R. 3184?
- If the SSTA is not approved by Congress, what cost-effective solutions would you propose to address State efforts to collect sales and use taxes?
- Explain the advantages or disadvantages of the SSTA and provide your assessment of H.R. 3184.

QUESTIONS FOR GEORGE ISAACSON, Tax Counsel, Direct Marketing Association

- You suggested in your testimony that State and local governments manipulate their tax regimes to meet the uniformity provisions of the SSTA. Please provide further explanation and any documentation on this issue that may exist. In your response, please explain what you believe to be the implications of this alleged practice and whether any solutions exist.
- What does the SSTA provide with respect to the costs of collection?

QUESTIONS FOR MAUREEN RIEHL, National Retail Federation

- You testified that "traditional sellers . . . also would like to be compensated." Transcript at 42. Is it necessary for this issue to be resolved and incorporated into the SSTA in order for Congress to act upon the agreement?
- You also testified that an outstanding issue between the retail community and the States is how to address catalog sales that are paid for by check. What are the options currently under discussion to address this issue?

- How do you propose this issue be resolved?

- Does the destination-based sales tax system provide an adequate solution?

- Will consumers be able to game the system by providing a destination with a more favorable tax or tax rate?

- Have there been surveys or empirical data that indicate the impact of remote sales taxes and tax collection on "mom-and-pop" retail operations and brick and mortar operations? Is there any negative impact on local economies?

ADDITIONAL QUESTIONS PRESENTED TO THE HONORABLE BILL OWENS BY THE HONORABLE CHRIS CANNON

October 14, 2003

The Honorable Bill Owens
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Denver, Colorado 80203-1792
Attn: Ms. Shelly Schafer

Dear Governor Owens:

Thank you for appearing before the Subcommittee on Commercial and Administrative Law on October 1, 2003. Your testimony, and the efforts you made to present it, are deeply appreciated and will help guide us in whatever action we take on the issue.

Attached is a copy of the official transcript of this hearing. We have provided this for your review. Please limit any corrections you make to technical, grammatical and typographical errors. This transcript is substantially a verbatim account of remarks actually made during the hearing. No substantive changes are permitted.

Pursuant to the unanimous consent request agreed upon at the hearing, Subcommittee Members were given the opportunity to submit written questions to the witnesses. Accordingly, I request that you respond to the following:

- Please respond to the statement submitted on the record by the National Conference of State Legislatures regarding your paper, "Nine Problems with Taxing the Internet."

In addition, questions from other Members of the Committee are attached. Your response to these questions will help inform subsequent action on this important topic. Please submit your written responses to these questions by 5:00 p.m. on Tuesday, October 28, 2003, to: Diane K. Taylor, Subcommittee on Commercial and Administrative Law, B353 Rayburn HOB, Washington, D.C.

Honorable Bill Owens
October 14, 2003
Page Two

20515. In addition, please provide your responses by e-mail to diane.taylor@mail.house.gov. If you have any questions, feel free to contact Diane K. Taylor at 202.225.2825. Thank you for your continued assistance.

Sincerely,

CHRIS CANNON
Chairman
Subcommittee on Commercial and Administrative Law

Enclosure

cc: Mr. Joel Harris

RESPONSES TO ADDITIONAL QUESTIONS BY THE HONORABLE BILL OWENS

STATE OF COLORADO

EXECUTIVE CHAMBERS

136 State Capitol
Denver, Colorado 80203-1792
Phone (303) 866-2471

Bill Owens
Governor

October 29, 2003

Hon. Chris Cannon
Chairman
Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
U.S. House of Representatives
B353 Rayburn House Office Building
Washington, DC 20515

ATTN: Diane K. Taylor

Dear Mr. Chairman:

Thank you again for the opportunity to testify before your Subcommittee on the important issue of Internet Taxation. As you requested, I have included a copy-edited transcript of my testimony.

Attached are answers to the questions posed to all panelists.

In addition, I have enclosed a detailed response to the paper produced by the National Conference of State Legislators that critiqued the study "Nine Problems With Taxing the Internet," that was published by the Center for the New American Century.

I congratulate you for your leadership in holding this hearing and offering Members the chance to discuss Internet taxation. Again, many thanks to you and to all the Subcommittee members for the opportunity to offer my thoughts on this issue.

Please don't hesitate to contact me if I can be of further help to you.

Sincerely,

Bill Owens

Response from Governor Bill Owens to Questions for All Panelists

- **What privacy issues or concerns exist under the proposed Streamlined Sales Tax Agreement (SSTA) that do not exist for other types of remote sales?**

  Please see the testimony transcript and response to NCSL document.

- **What is the status of the SSTA certified software**?

  Other witnesses can better speak to the technical details of this question.

- **There was testimony that the SSTA would increase offshore incorporation to avoid taxes. Is this a valid concern?**

  Please see the testimony transcript.

- **Is there or should there be a basis for providing access to the federal courts under the SSTA or HR 3184?**

  The hearing focused on the SSTA, and I have no assessment of the legislation at this time. However, the fact that the federal courts are offered as a solution to resolve the difficulties created by the agreement suggests that it has not adequately addressed the key issues it set out to resolve.

- **If the SSTA is not approved by Congress, what cost-effective solutions would you propose to address State efforts to collect sales and use taxes?**

  See the discussion of nexus in the testimony transcript.

- **Explain the advantages or disadvantages of the SSTA and provide your assessment of HR 3184.**

  Please see the testimony transcript. Since the hearing was on the SSTA, I have no assessment of the legislation at this time.

Response by Governor Bill Owens to the National Conference of State Legislatures on the Streamlined State Sales Tax Agreement

I. Is the Agreement revenue neutral?

NCSL:

Each state legislature has the authority or the ***sovereignty*** *to make their participation with the Agreement revenue neutral if they choose by lowering sales tax rates or by reducing other taxes such as property and/or income.*

Response:

How many state legislatures have used the passage of the SSTA to reduce the tax burden on their citizens? Moreover, in addition to the fact that the premise of the SSTA is to allow states to collect revenues they aren't collecting right now, participation in the SSTA will require some states to raise taxes by eliminating state caps on sales taxes.

II. Will the Agreement simplify tax compliance for America's merchants, as its proponents suggest?

NCSL:

Even if states did nothing more than adopt the proposed administrative changes contained in the Streamlined Sales and Use Tax Agreement, all vendors would enjoy reduced complexity. . . Under the Agreement, the certified technology calculates the sales tax to be collected not the merchant. The merchant does not need to determine the zip code. When the consumer is making a remote purchase, information such as zip code is obtained when the consumer fills in the delivery address. The certified technology that will be used by the merchant determines the sales tax, if any, on a purchase from the delivery address submitted by the consumer. When the Agreement is operational, all merchants that collect sales taxes using the state certified technology would be held harmless for any miscalculations. The state assumes the liability from the merchant, who under the current collection system bears total liability.

Response:

It is difficult to conclude that the tax collection burdens for an online or catalog company will be reduced under a national sales tax collection system like the SSTA. Today under the Supreme Court's *Quill* decision, an online or catalog company must comply with one state's tax laws and burdens. Under the SSTA and Congressional abolition of *Quill*, these companies will have to comply with 45 states' tax laws and burdens. Moreover, the SSTA does not protect vendors from all types of audits.

III. Does the Agreement pose threats to consumer privacy?

NCSL:

The Streamlined Sales and Use Tax Agreement has strong provisions that will protect the privacy of all consumers. The Agreement provides that a certified service provider "shall perform its tax calculation, remittance, and reporting functions without retaining the personally identifiable information of consumers." The only time that a certified service provider is allowed to retain personally identifiable information is if the buyer claims an exemption from taxation.

The Agreement requires the certified service providers to retain less information than is currently captured by VISA, MasterCard, American Express, Discover, or any other credit card company when a consumer makes a purchase and these companies can use this information for marketing purposes. If certified providers use or sell any information gathered from calculating sales taxes, they would lose certification to be a collector.

Let's set the record straight: the only information maintained by the vendor or third party collector for sales tax calculation are product, price, zip code, and sales tax collected. Unless the woman that is mentioned in Governor Owens' example is the only person living in the zip code, no one would know who she is!

Response:

The SSTA provides exceptions to its privacy provisions under the terms of the agreement (check the agreement for details). Also, there is an internal contradiction within the SSTA—it preserves the effect of each state's own privacy laws. What if a state law allows or requires the collection of personal information? How does the SSTA resolve this dispute?

IV. Will Agreement require your state and its local jurisdictions to forfeit sovereignty over tax policy in your state?

NCSL:

No, the Streamlined Sales and Use Tax Agreement does not force any state to forfeit its Compliance to the Agreement is always optional for a state. The decision to comply with the Agreement can only be made by the state legislature and governor—and they can withdraw at any time.

Response:

Saying that the SSTA does not require a surrender of sovereignty because membership is voluntary is like saying that the UN does not require a surrender of sovereignty. Once a state has completely overhauled its tax code and regulations to comply with the SSTA and obtain extraterritorial tax collection power, it is bound to submit its tax law to continual regulation by the SSTA governing board. Yes, a state can withdraw, but it will do so at great financial cost to its revenue stream which at that point will be embedded in the base budget. Practically it will be locked in.

V. Is the Agreement consistent with the Constitutional doctrine of federalism?

NCSL:

Yes. The Streamlined Sales and Use Tax Agreement does not in anyway violate the Constitution and is actually a vibrant example of federalism. The Agreement is voluntary for states and for merchants, this is not a mandatory compact or violation of the Commerce Clause of the Constitution. The states voluntarily participated in the process to formulate the Streamlined Sales and Use Tax Agreement by enacting legislation by the people's elected representatives in each state, signed by the governor. . .Should Congress grant states remote sales tax collection authority if they comply with the Agreement than businesses that are located in a state that "democratically chooses not to join the uniform tax scheme," would only be subject to collection requirements under the Agreement if that seller chooses to sell into a state that "democratically" decided to be party to the Agreement. . . . .However, no seller is forced to sell into states that comply with the Agreement. Out-of-state sellers make that decision and in doing so they also make themselves liable to the other state's non-sales taxes statutes and regulations protecting consumers and conducting business. An insurance company domiciled in Illinois must follow Colorado's insurance laws when doing business in Colorado, the same for banks and many other interstate businesses.

Response:

This betrays a profound misunderstanding of Internet commerce. More than any other tool in human history, the Internet facilitates the free movement of goods and the free flow of commerce. Yes, online retailers choose to sell in states where they don't have a physical nexus. This doesn't mean that those retailers should become the tax collectors for those states. It is inconsistent with federalism to allow the states that ratify this agreement to dictate tax policy to businesses in Colorado or other states that do not ratify the agreement.

VI. Will the Agreement reduce tax policy competition between states?

NCSL:

No. As has been stated many times, the state legislature in each state that complies with the Streamlined Sales and Use Tax Agreement will still decide what is taxed, who is exempt and at what rate it wants to tax transactions. How is tax competition "dumb downed" by simplified *administrative efficiency or even uniform product definitions? In fact, the competitive strength of America's businesses would be enhanced by reducing the regulatory complexity, costs and burden of the current state sales tax collection system on businesses . . . there is no mandatory collection authority unless Congress gives its consent and that will not happen if it appeared that this was an effort by a handful of "non-competitive" states wanting to "piggy-back on the economic investments of 40 other states." Finally, as of July 8, 2003, 20 states representing over 30 percent of the population have enacted legislation to comply with the Streamlined Sales and Use Tax Agreement.*

Response:

Reducing regulatory costs and burdens is a laudable goal. However, it is difficult to see how simplicity and efficiency are achieved when new tax collection burdens are foisted on an entire new class of businesses, burdens that involve collecting taxes in thousands of jurisdictions where those businesses have no representation.

VII. Will the Agreement impede the success of the technology revolution?

NCSL:

Under the Streamlined Sales and Use Tax Agreement, the buyer making a transaction will not need to fill out any additional forms in order for the sales tax to be calculated or collected. The tax is determined by the delivery address, and anyone who is buying a tangible product online wants to make sure that the product is delivered to the right address. The consumer fills out only one address field . . . A study released by Jupiter Research in January 2003 "Sales Tax Avoidance Is Imperative to Few Online Retailers and Ultimately Futile for All" found most people are unaware that they are not paying sales taxes when they make a purchase over the Internet. In the same study by Jupiter, only 4 percent of online buyers said that the collection of sales and use taxes would always affect their decision to buy online. . .Those who oppose applying sales taxes to purchase of digital goods such as books, movies and magazines are, no doubt inadvertently, arguing in favor of keeping pornography tax-free. . . If a state taxes the purchase of an adult or x-rated magazine in the real world, why should the same magazine downloaded or delivered electronically not be taxed?

Response:

Economics 101 tells us that when you tax something, you get less of it, and the study of Internet commerce bears this out. A 1999 study by Professor Austin Goolsbee showed that the extension of sales taxes to Internet purchases could reduce the number of online buyers by as much as 24 percent.

The Owens Administration has vigilantly prosecuted illegal pornography. In Colorado, we eliminated the requirement that there be an exchange of money or value before something counts as child pornography trafficking. This means we can prosecute child pornographers even if there's no commercial transaction. If the proponents of SSTA are truly concerned about taxing pornography, then surely they can find a way to do it without increasing taxes on consumers and burdens on businesses that have nothing to do with that item.

VIII. Will the Agreement hurt certain citizens more than others?

NCSL:

If brick and mortar stores are not as accessible in rural areas as they were ten years ago, perhaps they no longer can afford to compete with the price advantage enjoyed by online/remote sellers that do not collect sales taxes. When brick and mortar stores in rural areas are forced out of business that means the rural farmer will have to pay higher property taxes on his farm or increased state income taxes. Higher property or income taxes, just so that one can buy a book or CD on-line sales tax free? Governor Owens implies that the streamlined sales tax effort will "have the effect of widening the so-called "digital divide." Unfortunately he fails to show an equal concern for those hard working Americans who may lack the credit or the ability to shop on line because of a lack of access to the Internet or even a computer. . .

Response:

This argument ignores the positive impact that e-commerce has on the lives of rural and disabled consumers, as well as the tax breaks and exemptions available to Main Street businesses that aren't available to online retailers.

IX. Will the Agreement really promote equity between brick-and-mortar and online retailers?

NCSL:

As was stated previously, the Streamlined Sales and Use Tax Agreement requires states to compensate merchants for compliance. However Governor Owens' White Paper contradicts itself. Earlier in the White Paper, Governor Owens states, "Those states that do not currently reimburse in-state merchants for their costs of collection will be mandated to pay a uniform reimbursement rate for all merchants, whether in state or out-of-state." Now he writes those online merchants will be disadvantaged compared to brick and mortar sellers because of compliance costs.

Governor Owens' white paper ignores the fact that the online merchant does not pay the sales tax; rather the merchant merely collects the sales tax from the buyer and remits it to the state where the buyer resides or to where the purchase is being delivered and used. The online seller *receives all the "many benefits governments sometimes offer traditional retailer" in the state(s) they are located.*

Response:

The SSTA will require states that are not currently providing reimbursement to reimburse for the costs of collection, so state expenses could go up in some cases. At the same, there is no doubt that new burdens are placed on catalog and online retailers. Besides the fact that they would be required to collect sales tax in thousands of jurisdictions around the country, other questions arise: will the state "reimbursements" truly cover their costs? What happens when a consumer owes a sales tax online but fails to pay it? (Answer: the online retailer eats that cost).

ADDITIONAL QUESTIONS PRESENTED TO MS. MAUREEN RIEHL BY THE HONORABLE CHRIS CANNON

October 14, 2003

Maureen Riehl, Esq.
National Retail Federation
Liberty Place
325 7th St., NW
Suite 1100
Washington, D.C. 20004

Dear Ms. Riehl:

Thank you for appearing before the Subcommittee on Commercial and Administrative Law on October 1, 2003. Your testimony, and the efforts you made to present it, are deeply appreciated and will help guide us in whatever action we take on the issue.

Attached is a copy of the official transcript of this hearing. We have provided this for your review. Please limit any corrections you make to technical, grammatical and typographical errors. This transcript is substantially a verbatim account of remarks actually made during the hearing. No substantive changes are permitted.

Pursuant to the unanimous consent request agreed upon at the hearing, Subcommittee Members were given the opportunity to submit written questions to the witnesses. Accordingly, I request that you respond to the following:

- In his testimony, Mr. Isaacson stated that the Streamlined Sales Tax Project abandoned its initial goal of establishing one tax rate per State. Please respond. If Congress is to help the States create a tax system that is more convenient for consumers and retailers, shouldn't such a system reduce the number of tax jurisdictions?

- At what stage of development is the tax collection software pledged to be tested by the Project? What assurances can advocates of the SSTA provide that tax collection software has been developed that will successfully administer the tax systems of all States participating in the Project?

Ms. Maureen Riehl
October 14, 2003
Page Two

In addition, questions from other Members of the Committee are attached. Your response to these questions will help inform subsequent action on this important topic. Please submit your written responses to these questions by 5:00 p.m. on Tuesday, October 28, 2003, to: Diane K. Taylor, Subcommittee on Commercial and Administrative Law, B353 Rayburn HOB, Washington, D.C. 20515. In addition, please provide your responses by e-mail to diane.taylor@mail.house.gov. If you have any questions, feel free to contact Diane K. Taylor at 202.225.2825. Thank you for your continued assistance.

Sincerely,

CHRIS CANNON
Chairman
Subcommittee on Commercial and Administrative Law

Enclosure

RESPONSES TO ADDITIONAL QUESTIONS BY MS. MAUREEN RIEHL

October 28, 2003

The Honorable Chris Cannon
Subcommittee on Commercial and
Administrative Law
U.S. House of Representatives
2138 Rayburn House Office Building
Washington, D.C. 20515-6216

RE: Response to questions regarding October 1, 2003 testimony regarding States' Efforts to Streamline the Administration of Sales and Use Tax Laws

Dear Chairman Cannon:

Thank you for your letter of October 14, 2003, inviting the National Retail Federation to review the written transcript and to also respond to some questions following the October 1, 2003, hearing held on the issue of the Streamlined Sales Tax Agreement and States' Efforts to Streamline the Administration of Sales and Use Tax Laws.

Transcript Corrections:

Page 18, Line 380: Strike, "and avoid," and replace with "rather than . . . "

Page 20, Line 425: Strike, "Association" and replace with "Federation."

Questions and Answers:

Below are the responses of the National Retail Federation to questions posed by the Chairman and members of the subcommittee:

1) **In his testimony, Mr. Isaacson stated that the Streamlined Sales Tax Project abandoned its initial goal of establishing one rate per State. Please respond. If Congress is to help the States create a system that is more convenient for consumers and retailers, shouldn't such a system reduce the number of tax jurisdictions?**

The Streamlined Sales Tax Project (SSTP) was never charged with nor did it adopt as a goal, one rate per state.

SSTP and the later convened decision-making body of the Streamlined Sales Tax Implementing States (SSTIS) operates under principles adopted in July 1999 by the National Conference of State Legislatures' Executive Committee Task

Force on State and Local Taxation of Telecommunications and Electronic Commerce. While a limitation on the number of rates is not identified as a principle, Principle #4 of seven states, "that states recognize the need to undertake significant simplification of state and local sales and use taxes to reduce the administrative burden of collection."

While the SSTP and the SSTIS gave the one-rate issue several months of discussion, debate and consideration in deference to pressure from direct marketers, in the end, business agreed with the SSTIS that one-rate-per-zip-code satisfied the need for certainty in the application of rates - placing the burden on the state to maintain web-based or telephonic-accessible charts that assign a specific tax rate to a specific zip code. Retailers agree that the bigger complexities in tax calculation have to do with defining products and knowing whether the defined item is taxable.

Furthermore, requiring one-rate-per-state is a direct infringement on state sovereignty. States such as Governor Owens' Colorado with their constitutionally-established home rule have 200+ separate taxing jurisdictions. One-rate-per-zip code provides certainty for sellers without impairing the right of a state or local government to make decisions on what is taxed and what rate applies within that jurisidiction.

2) At what stage of development is the tax collection software pledged to be tested by the Project? What assurances can advocates of the SSTA provide that the Tax collection software has been developed that will successfully administer the tax systems of all States participating in the Project?

Software is still being developed and fine-tuned. Software providers and a handful of retailers have been testing versions of software since mid-2001, assuming various simplification features. Most medium to large retailers today (pre-simplified system) use some modified version of the major tax collection software currently available.

Market forces will dictate the speed of development, options, deployment and cost of reliable sales and use tax collection software. Congressional action to transition SSTA to a mandatory system will facilitate these market forces because the market will be defined, there will be a guarantee of payment by the Governing Board of the SSTA to certified providers, and states and businesses will both be in need of an affordable solution. Likewise, since no remote seller will be compelled to "hook-up" unless or until Congress mandates collection, the field of new software provider competitors will be stymied until the pool of "clients" is expanded beyond the current users.

3) What privacy issues or concerns exist under the proposed Streamlined Sales Tax Agreement (SSTA) that do not exist for other types of remote sales?

There are no additional privacy concerns.

Article III ("Requirements Each State Must Accept to Participate") of the Streamlined Sales and Use Tax Agreement adopted on November 12, 2002, Section 321 ("Confidentiality and Privacy Protections under Model I") provides detailed restrictions on the collection and use of data collected by third party collectors on behalf of sellers. Use of in-house tax collection software or an in-house tax system by a seller will utilize the same privacy limitations in place today.

Additionally, H.R. 3184 by Mr. Istook and Mr. Delahunt requires the SSTA provide, "appropriate protections for consumer privacy." Subsection (13) of Section 6, "Minimum Simplification Requirements," addresses privacy as part of a list of items that must be maintained in the current and future versions of the SSTA in order for states to mandate collection of tax from remote sellers.

a. What role does Congress have in ensuring that the agreement includes privacy standards, auditing provisions and penalties for breach?

As mentioned above, privacy is appropriately addressed in H.R. 3184. Likewise, the Governing Board of the SSTA, with ongoing input from both business and consumers, will be required to maintain necessary privacy protections for the new system - or be sued for failure to do so, or worse yet, loose the right to require tax collection.

b. If the States fail to include privacy standards in the agreement, should Congress refuse to sanction the SSTA? Explain the rationale.

This is a moot point. The answer would be yes if no standards existed.

4) What is the status of the SSTA certified software?

As stated earlier, software is still under development. As the market expands, so will competition. Retailers expect that software availability will track the anticipated dates for implementation and full operation of the voluntary SSTA - which will likely be no sooner than the end of 2004 at the earliest.

Under a mandatory system achieved by H.R. 3184, NRF insists that all aspects of the SSTA be operational - including the application of requisite software - before any remote seller be required to collect.

5) There was testimony that the SSTA would increase offshore incorporation to avoid taxes. Is that a valid concern?

No. Tangible products still have to enter the country to be delivered to the purchaser. The purchaser still owes the tax if the product is taxed in his or her home state, even if it is not collected by a "foreign" entity. Other factors in addition to tax collection avoidance would be at work for a US-based company to choose to replace tax collection responsibility (a cost paid for by the states) with international customs and tariff management. This does not make good business sense for most retailers.

6) Is there or should there be a basis for providing access to the federal courts under the SSTA or H.R. 3184?

Yes. Access to federal courts for a mandatory collection system is provided under H.R. 3184, Section 5, to the United States Court of Federal Claims. As a strictly voluntary agreement, Article X of the SSTA provides no arbiter of issue disputes beyond the Governing Board.

7) If the SSTA is not approved by Congress, what cost-effective solutions would you propose to address State efforts to collect sales and use taxes?

Even without action by Congress, SSTA as a purely voluntary system will provide immediate cost savings to businesses as well as state government in the states that have adopted and will adopt the SSTA because of the reduction in administrative functions and processes. Cost and complexity reduction are important achievements of SSTA - but the ultimate goal of NRF and other businesses is mandatory and equal collection responsibility for all sellers, which can only be achieved either by an act of Congress, or through costly litigation. No action by Congress means that retailers and other businesses will be exposed to aggressive state tax auditors who continue to stretch and contort the definition of nexus.

8) Explain the advantages or disadvantages of the SSTA and provide your assessment of H.R. 3184.

The advantages of a voluntary system created by SSTA to retailers are multiple, but primarily include:

- Centralized administration at the state level of all sales and use taxes (Sec. 301);
- Uniform exemption certificates with a shift in the burden to the state for

authentication (Sec. 317);

- Limitations on audits and a hold-harmless provision for mistakes made by retailers using a state authorized system or software program (Sec. Sec. 306);
- Certainty through common definitions for products and tax terms (Article ii and Sec. 327, 328);
- Limited rates (Sec. 308).

One disadvantage of SSTA alone, is that it is voluntary for remote sellers to participate.

H.R. 3184 is a prime example of a carefully crafted balance between simplification and sovereignty. H.R. 3184 is a value-added improvement for retailers to all the provisions above (Sec. 6 of H.R. 3184), magnified by the creation of a mandatory tax collection system (Sec. 4). In the absence of legislation by Congress, states will force businesses into litigation in order to get the uncollected tax revenue - and the courts will not provide benefits only Congress can ensure. Benefits which improve the SSTA for all businesses are enumerated under H.R. 3184, and include:

- A small business exception of $5 million in gross remote taxable sales nationwide (Sec. 4 (b));
- A right of appeal to the United States Court of Federal Claims for taxpayers or businesses not dealt with fairly by the Governing Board (Sec. 5);
- Reasonable seller compensation for all sellers, and additional compensation for a four-year period for remote sellers currently not obligated to collect (Sec. 4 (c));
- A firewall protection against use of sales tax information for business activity assessments or other income taxes (Sec. 3; Sec. 6 (1); Sec. 7 (b)).

Questions for MAUREEN RIEHL, National Retail Federation:

1) **You testified that "traditional sellers . . . also would like to be compensated." Transcript at 42. Is it necessary for this issue to be resolved and incorporated into the SSTA in order for Congress to act upon the agreement?**

Compensation for traditional sellers is identified in H.R. 3184 in Section 4 (c), and also listed as a minimum simplification requirement under Section 6 (12).

2) **You also testified that an outstanding issue between the retail community and the States is how to address catalog sales that are paid for by check. What are the options currently under discussion to address this issue?**

This issue is an ongoing discussion with the SSTP, and will be addressed by the SSTIS and Governing Board prior to SSTA being operational. Currently, the largest catalog merchants, JC Penney and Sears' Land's End, either absorb the sales tax for the customer for smaller items, or re-invoice for large tax differences. Even though JC Penney reports to NRF that payment by check has dropped significantly in recent years, it is still important to maintain as a payment method (a preferred method by some seniors and rural customers). While no specific option is on the table, approaches will center on a state-based, retailer-based, or customer-based collection or remittance process.

a. How do you propose this issue be resolved?

It needs more discussion, and a workable solution should be adopted by the SSTIS/Governing Board prior to the SSTA becoming operational. NRF and its members JC Penney, Land's End and other catalogue merchants have a vested interest in this being resolved, and we will spearhead resolution of this effort with the SSTIS/Governing Board.

b. Does the destination-based sales tax system provide an adequate solution?

Yes. Independent of the pay-by-check solution, the state will have to provide and maintain a taxability table, and make it easily accessible to either the customer or the retailer. This would have to be accessible in multiple ways - by toll-free phone and Internet.

c. Will consumers be able to game the system by providing a destination with a more favorable tax or tax rate?

Yes, but it requires some gymnastics on the part of the consumer, just the same as exists now for point of sale purchases made near the borders of non-sales tax states. At some point, the consumer has to retrieve the goods from wherever they were delivered - costing time and or money or both. Absent a vigorous audit of individual taxpayers for all remote goods purchased - itself a political landmine which is not endorsed by the retail community as a viable option - some revenue collection could be avoided.

3) Have there been surveys or empirical data that indicate the impact of remote sales taxes and tax collection on "mom-and-pop" retail operations and brick and mortar operations? Is there any negative impact on local economies?

NRF's membership includes a very active Independent Stores Board and hundreds of small "mom-and-pop" sellers, which as a body have long supported the NRF position of equal collection responsibility for all sellers. In these budget-strapped times for states, use tax that goes unpaid by consumers and uncollected by the state subjects in-state sellers to pressures of possible increases in income, property or an increase in the sales tax rate to meet core needs.

Small businesses in an SSTA state will automatically benefit from the cost reductions and audit limitations mentioned previously. Likewise, under a mandatory system, only an act of Congress such as H.R. 3184 (as opposed to a court decision) will carve out an exemption for small business for remote sales on taxable items totaling $5 million or less.

One study about the overall sales tax issue is worth noting, conducted by Jupiter Research in January 2003, and entitled, *Sales Tax: Avoidance is Imperative to Few Online Retailers and Ultimately Futile for All.* A copy of the study is available at www.jupiteresearch.com.

Thank you for the opportunity to respond to your questions about the SSTA, an issue of vital importance to the National Retail Federation. Please do not hesitate to contact me at 202-626-8121 or at riehlm@nrf.com if I can be of any further assistance.

Sincerely,

Maureen B. Riehl
Vice President
State & Government Relations Counsel
National Retail Federation

cc: Members of the Judiciary Subcommittee on Commercial and Administrative Law

ADDITIONAL QUESTIONS PRESENTED TO MR. GEORGE ISAACSON BY THE HONORABLE CHRIS CANNON

October 14, 2003

George Isaacson, Esq.
Brann & Isaacson
184 Main Street
P.O. Box 3070
Lewiston, ME 04243

Dear Mr. Isaacson:

Thank you for appearing before the Subcommittee on Commercial and Administrative Law on October 1, 2003. Your testimony, and the efforts you made to present it, are deeply appreciated and will help guide us in whatever action we take on the issue.

Attached is a copy of the official transcript of this hearing. We have provided this for your review. Please limit any corrections you make to technical, grammatical and typographical errors. This transcript is substantially a verbatim account of remarks actually made during the hearing. No substantive changes are permitted.

Pursuant to the unanimous consent request agreed upon at the hearing, Subcommittee Members were given the opportunity to submit written questions to the witnesses. Accordingly, I request that you respond to the following:

- Your written testimony raised many points about the Streamlined Sales and Use Tax Agreement (SSTA) not discussed at the hearing. Please describe or elaborate upon those aspects about which, in your opinion, Members of Congress should be aware in order to make a reasoned assessment of the SSTA.

In addition, questions from other Members of the Committee are attached. Your response to these questions will help inform subsequent action on this important topic. Please submit your written responses to these questions by 5:00 p.m. on Tuesday, October 28, 2003, to: Diane K. Taylor, Subcommittee on Commercial and Administrative Law, B353 Rayburn HOB, Washington, D.C. 20515. In addition, please provide your responses by e-mail to diane.taylor@mail.house.gov. If you have any questions, feel free to contact Diane K. Taylor at 202.225.2825. Thank you for your continued assistance.

Sincerely,

CHRIS CANNON
Chairman
Subcommittee on Commercial and Administrative Law

Enclosure

Responses to Additional Questions by Mr. George Isaacson

BRANN & ISAACSON
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October 27, 2003

Chris Cannon, Chairman
Subcommittee on Commercial and Administrative Law
Congress of the United States
House of Representatives
Committee on the Judiciary
2138 Rayburn House Office Building
Washington, DC 20515-616

RE: SSTA Hearing – Following Up Questions

Dear Chairman Cannon:

Thank you for the opportunity to respond to the questions in, and accompanying, your letter dated October 14, 2003.

1. Please describe or elaborate upon those aspects about which, in your opinion, Members of Congress should be aware in order to make a reasonable assessment of the SSTA.

My written testimony submitted in connection with the hearing on October 1, 2003, sets forth in detail a number of structural and functional problems with the SSTA which Congress should consider in making a reasoned assessment of the Streamlined Sales and Use Tax Agreement ("SSTA"). As I explained, the states participating in the Streamlined Sales Tax Project ("SSTP") have failed to meet even their own original goals for simplification of state and local sales and use tax laws. Those shortcomings are reason enough for Congress to direct the states back to the drawing board. (For a full discussion of the shortcomings of the SSTA, please see my written testimony, pages 6-34.)

Congress should be acutely aware, however, that federal legislation empowering states to impose the complex and untested sales and use tax system established under the SSTA would seriously impede America's economic recovery. Small and medium-sized businesses will suffer the most under the SSTA. Large companies and "big box" merchants are able to absorb the enormous burdens imposed by multi-state tax collection responsibilities. (At the October 1 hearing, General Counsel for Staples testified that his company employs 30 full-time employees to comply with state sales and use tax requirements.) Small and medium-sized businesses, however, cannot afford the substantial resources that retailers like Staples devote to tax

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compliance in multiple states. Indeed, the Wal-Marts, Targets, Staples, etc. would be the real beneficiaries of a Congressionally-authorized expansion of state tax authority that imposes difficult tax compliance burdens on their internet competitors, regardless of their location. America's economy, and its small and medium-sized internet businesses, will be the losers. The Internet will no longer be the incubator of innovative start-up companies, nor will it provide access to a national market for small and medium-sized retailers. (For full discussion of these issues, please see my written testimony, pages 38-42.)

Congress should also recognize that the states' request for federal approval of the SSTA is premature. There is currently no functioning SSTA system. Indeed, the participating states have failed not only to achieve meaningful simplification of state and local sales and use tax laws, they have also failed to demonstrate that the tax compliance software that they envision relying upon to make the system work can even be developed. There are no Certified Service Providers (the central feature of the SSTA) who have been identified to run the system. Moreover, the states do not yet know what costs the system will impose upon multi-state retailers. There is not even an SSTA Governing Board in place. Significantly, no state has successfully conformed its laws to the Agreement. In short, Congress is being asked to approve a massive new tax system, and greatly expand tax burdens on interstate retailers and their customers, before the states have shown the system can work. Until the states can demonstrate to Congress that they have developed a fair and fully-functioning tax collection system, one which contains safeguards for marketers and consumers, Congress should decline to expand state taxing powers in a manner that would alter constitutional standards that have served this country well since its founding.

2. **What privacy issues or concerns exist under the proposed Streamlined Sales Tax Agreement (SSTA) that do not exist for other types of remote sales?**

    a. **What role does Congress have in ensuring that the agreement includes privacy standards, auditing provisions and penalties for breach?**

    b. **If the States fail to include privacy standards in the agreement, should Congress refuse to sanction the SSTA? Explain the rationale.**

In its current form, the SSTA represents an unprecedented threat to the private personal and financial data of millions of American consumers. To enable tax reporting and remittance, as well as the performance of audit functions, the SSTA system will collect massive amounts of information regarding individual consumer transactions. That information will be retained and made available not only to state revenue departments (who are authorized to share the information with their counterparts in other states) but also to the private companies that are designated to act as "Certified Service Providers," as well as to their subcontractors. Consequently, confidential on-line customer transactional information will be distributed widely

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both within various state government agencies and among private companies. There is no similar extensive information-sharing regime in place for remote sales by interstate retailers today.

The states are asking Congress to endorse this new tax system, despite the fact that the SSTA contains no meaningful protections for the personal and financial information of American consumers. Congress should not approve the widespread dissemination of such information in the absence of stringent privacy protections. At a minimum, Congress should require that:

- All persons, whether public workers or employees of private Certified Service Providers and their subcontractors, who have access to consumer information under the SSTA, must be identified by name and logged into permanent records, so that access to information and unauthorized disclosures can be monitored and a system of accountability maintained;

- The information collected be limited only to that data necessary to ensure that sales/use tax payments have been properly credited and remitted;

- The collection of personally identifiable information be strictly limited and no product-specific information be obtained;

- Private financial data, such as credit card information, not be collected or retained by a participating state or Certified Service Provider;

- All personally identifiable information be destroyed after tax payments have been properly credited;

- Participating state revenue departments, as well as all Certified Service Providers and their subcontractors, be subject to annual audits by an independent, non-governmental privacy monitoring organization to assess their conformance with applicable privacy standards and the results of the privacy audits be publicly disclosed;

- The security of all computer systems and other data and file retention systems used by participating state revenue departments, Certified Service Providers and their subcontractors be certified by an independent, non-governmental computer information and security organization as being adequate to protect confidential consumer information and the results of the security audits be publicly disclosed;

- Consumers be provided notice of the applicable privacy standards and practices including the right, at no expense to the consumer, to disclosure of all consumer-specific information retained by an SSTA participating state or Certified Service Provider;

- Consumers be provided prompt notice if anyone other than a participating state or Certified Services Provider is provided, or attempts to obtain, access to their confidential information;

- An intentional breach of the applicable privacy standards shall constitute a federal criminal violation subject to prosecution in federal court and stringent penalties; and

- An unintentional breach of the applicable privacy protections should constitute a civil offense subject to federal court jurisdiction and stipulated damages for each violation.

3. What is the status of the SSTA certified software?

Fully-functional tax compliance software is the SSTP's "silver bullet" to slay the otherwise overwhelming complexities of differing state tax systems. To date, however, no such computer software has been developed, nor is there any indication that such software is even feasible. The status of the SSTA's efforts to develop such software is reported in the SSTP Pilot Status Report issued March 26, 2003 ("Status Report"), available at www.streamlinesalestax.org/pilot3_03.html.

As discussed in my testimony (at pages 11-15), the Status Report demonstrates that commercially-available compliance software simply does not yet exist. Indeed, even if it is feasible (which industry and software experts question), the development of tax compliance software is impossible until the SSTA process is complete, has achieved meaningful simplification and uniformity of state sales and use tax laws, and all participating states have conformed their laws to SSTA requirements. The absence of a functioning SSTA system against which software developers can attempt to devise tax compliance software is one primary reason why consideration of the SSTA by Congress is simply premature.

4. There was testimony that the SSTA would increase offshore incorporation to avoid taxes. Is this a valid concern?

Yes. The SSTA does not, and can not, extend the jurisdictional reach of state and local governments to foreign firms. Consequently, by imposing tax collection obligations on direct marketers in the United States, the SSTA will give a competitive advantage to foreign firms that do not have such obligations. American firms will be disadvantaged in all sectors of e-commerce, but in particular with respect to the sale of digital products.

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An increasing number of states are taxing digital products, and the SSTA expressly contemplates that the taxation of digital products will be covered under expanded state taxation powers. Digital products can, however, be delivered electronically to American consumers from anywhere in the world. E-merchants and catalog companies will locate themselves where the costs of doing business and the tax environment are most attractive. Large sectors of the direct marketing industry are already under considerable pressure to move overseas; the SSTA would exacerbate these pressures. It would be ironic for this Congress, which is attempting to reinvigorate the U.S. economy, to instead accelerate the flow of jobs overseas by imposing new burdens on the very economic sector in which the United States has been the unchallenged world leader, *i.e.*, electronic commerce.

5. **Is there or should there be a basis for providing access to the federal courts under the SSTA or H.R. 3184?**

Federal court jurisdiction is a necessary *quid pro quo* for the states' request for extra-territorial taxing powers. The provision in H.R.3184 for Court of Claims jurisdiction for limited review of decisions by the Governing Board is not adequate. When, and if, the states present Congress with a truly streamlined sales and use tax system, Congress should include in any authorizing legislation federal district court jurisdiction over all tax disputes involving questions of federal law. If states, through federal legislation, seek to remove existing constitutional limitations on the scope of their taxing jurisdiction and to impose collection obligations on companies located in other states, then such companies should have access to federal court to contest tax assessments that violate the provisions of the new federal legislation or, for that matter, any remaining constitutional protections such companies may have. Accordingly, legislation that would override the constitutional restrictions on state taxing authority reaffirmed in *Quill Corp. v. North Dakota* should be accompanied by a repeal of the Federal Tax Injunction Act, 28 U.S.C. § 1341,[1] as it applies to sales and use taxes administered under the SSTA.

6. **If the SSTA is not approved by Congress, what cost-effective solutions would you propose to address State efforts to collect sales and use taxes?**

The problem of under-collection by the states of use taxes on remote sales has been grossly over-stated by proponents of the SSTA, as proven by the study conducted by economist Dr. Peter Johnson, which was submitted with my testimony and discussed therein.

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1 The Tax Injunction Act provides that "[t]he district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State." 28 U.S.C. § 1341.

In addition to being exaggerated, the problem of under-collection is, in many ways, self-correcting. Market forces do a good job of promoting collection of use taxes on remote sales in the long run. As direct marketers grow their businesses, they tend to expand their presence into additional states. Many retailers adopt a "clicks and mortar" approach, marketing goods both over the Internet and through retail stores located in multiple states. Such "clicks and mortar" businesses generally recognize that there are efficiencies and cross-marketing opportunities inherent in a multi-channel retail strategy. These business advantages lead such retailers to begin voluntarily collecting use taxes on Internet and other remote sales. Eddie Bauer, Lands' End, L. L. Bean, among many others, are good examples of companies which have commenced collection of use taxes on their remote Internet sales in states where they have expanded their businesses by opening retail stores.

Another cost-effective solution to increase use tax collection is the inclusion of a use tax reporting line on personal state income tax returns. Several states have generated additional revenues by simply instructing their citizens to remit use taxes with their personal income taxes. The cost of including a line for use tax reporting on a state's personal income tax return is negligible. In connection with such self-reporting arrangements, state governments should undertake appropriate consumer education programs.

7. Explain the advantages or disadvantages of the SSTA and provide your assessment of H.R. 3184.

The SSTA's failure to have achieved meaningful simplification of state sales and use tax laws, as well as its detrimental impact on interstate retailers, the intrusion it threatens on the privacy of American consumers, and its probable adverse impact on the U.S. economy, are all discussed at length in my testimony. As I have emphasized in these responses, consideration of the SSTA by Congress is premature, because the system it envisions is both speculative and theoretical at the current time. The SSTA proponents have not presented Congress with a practical, functional road-tested system.

H.R. 3184 is written in generalities to such a large extent that it fails to correct most of these shortcomings of the SSTA, but, instead, broadly endorses and approves them. The proper solution is for the participating states to draft an SSTA that provides for meaningful simplification of their sales and use tax regimes, to enact true conformity legislation, and then to operate the system on a voluntarily basis for a test period to determine its viability. Only after the states have demonstrated that they have developed an integrated and fully-functional sales and use tax system should Congress consider legislation imposing the SSTA on non-resident catalog companies and electronic merchants.

8. You suggested in your testimony that State and local governments manipulate their tax regimes to meet the uniformity provisions of the SSTA. Please provide further explanation and any documentation on this issue that may exist. In your response, please explain what you believe to be the implications of this alleged practice and whether any solutions exist.

State legislatures have used a variety of mechanisms to achieve the guise of compliance with the SSTA, while in fact avoiding its requirements. A number of states have simply omitted key provisions of the Agreement. Other states have renamed existing sales taxes or adopted new "special taxes" outside of their sales and use tax laws that would otherwise not be permitted under the SSTA. Several states have used the SSTA to impose tax increases or new taxes, rather than to simplify existing tax regimes. Some states have adopted and retained conflicting definitions for terms that are expressly defined by the SSTA. Nearly every state declares its conformity to the SSTA with great fanfare, but a careful review demonstrates that no state has yet achieved it. Examples of all of these problems with state conformity legislation are set forth in my written testimony, at pages 35-38.

The clear implication of these legislative maneuvers is that even at the very earliest stages of state efforts to achieve a modicum of uniformity in sales and use tax laws, state legislatures are finding imaginative – and not so imaginative – ways to flaunt the SSTA's requirements. If participating states can not toe-the-line at a time when such states are trying to impress upon Congress their commitment to simplification and uniformity, how can Congress, or retailers, have any confidence that the SSTA will successfully harmonize the sales and use tax laws of thousands of jurisdictions? Moreover, if Congress grants the states expanded tax jurisdiction by approving the SSTA, the incentive for states legislatures to yield to local pressures and evade uniformity structures will only increase. Many states that have not yet passed conformity legislation have been stymied by long-standing or unique features of local law that conflict with the SSTA. If Congress sanctions state legislative gamesmanship by approving the SSTA with the sort of initial "conformity" legislation states have enacted to date, remaining state legislatures will be encouraged to pursue creative draftsmanship, not real reform.

Congress can put in place procedural safeguards to limit the ability of participating states to avoid the requirements of the Agreement. First, Congress should insist that states fully conform their laws to the requirements of the Agreement, rather than approving the weak "substantial compliance" standard set forth in the Agreement. Next, and perhaps most importantly, Congress should delegate to a federal agency, not the SSTA Governing Board, the responsibility to verify the states compliance with the Agreement. Finally, Congress should give the federal district courts jurisdiction over disputes arising under the SSTA system, as described in my response to question no. 5, above. Empowering federal courts to adjudicate disputes under the SSTA system will ensure consistent interpretation of the SSTA and limit the states' ability to deviate from the Agreement.[2]

9. What does the SSTA provide with respect to the costs of collection?

The SSTA does not guarantee compensation to retailers for their compliance costs. Instead, the Agreement provides that only states "anticipate" establishing compensation measures for businesses, either Certified Service Providers, retailers, or both, that incur compliance costs in connection with collecting and remitting use tax to the participating states. Even the "anticipated" compensation does not extend beyond the first twenty-four months of a retailer's collection of tax under the SSTA. In fact, the states do not even know what compliance cost retailers will face under the agreement. A joint government-industry cost of collection study on which the SSTA intends to rely has never been completed.

The failure of the states to guarantee compensation for tax compliance costs is simply unfair. Sellers incur substantial expense in collecting and remitting sales and use taxes to states. The variety and inconsistency of state tax systems makes compliance expensive for all multistate retailers, but especially for low volume merchants. A study by a major accounting firm reported that for companies selling products nationally with collection responsibilities in all of the 45 states that have sales and use taxes, the costs of compliance ranged from 14 percent of the sales taxes collected for large retailers, to 48 percent for medium-sized retailers, to 87 percent for small retailers.[3] If states want to require retailers to act as their tax collection agents, they should determine fair compensation for their efforts and commit to pay it.

Chairman Cannon, I want to thank you and the Committee again for the opportunity to testify before you on these important issues. I hope my responses to these questions are useful to the Committee's work. Thank you for your time and attention.

Very truly yours,

George S. Isaacson

GSI/dmg

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2 Apart from such procedural measures, Congress might also require that the Agreement define the terms "sales tax" and "use tax," to limit the ability of states to create "special" taxes outside of their sales and use tax laws.

3 Cline and Neubig, "Masters Of Complexity And Bearers Of Great Burden: The Sales Tax System and Compliance Costs For Multistate Retailers," Ernst & Young Economics Consulting and Quantitative Analysis, September 1999.

ADDITIONAL QUESTIONS PRESENTED TO MR. JACK VANWOERKOM BY THE HONORABLE CHRIS CANNON

October 14, 2003

Jack VanWoerkom, Esq.
c/o Piper Rudnick LLP
1200 Nineteenth Street, N.W.
Washington, D.C. 20036-2412
Attn: Ms. Lisa Jones

Dear Mr. VanWoerkom:

Thank you for appearing before the Subcommittee on Commercial and Administrative Law on October 1, 2003. Your testimony, and the efforts you made to present it, are deeply appreciated and will help guide us in whatever action we take on the issue.

Attached is a copy of the official transcript of this hearing. We have provided this for your review. Please limit any corrections you make to technical, grammatical and typographical errors. This transcript is substantially a verbatim account of remarks actually made during the hearing. No substantive changes are permitted.

Pursuant to the unanimous consent request agreed upon at the hearing, Subcommittee Members were given the opportunity to submit written questions to the witnesses. Accordingly, I request that you respond to the following:

- Would you support federal legislation on the subject of State sales taxes that included a provision requiring 100 percent State reimbursement of vendors for all of the reasonable administrative expenses they incur in the collection and remittance of State taxes?

- Many municipalities have tax incentive programs available to shopping mall developers and various free government services designed to attract new development to their communities. These include TIF programs (Tax Incentive Financing), rebates of sales taxes, tax relief for hiring new employees, and even installation of infrastructure such as freeway exits, sewer lines, lighting, etc. Has Staples benefitted from such programs? Out-of-state merchants are not eligible to participate in any of these government-sponsored benefits. Is it fair to ask Internet

Mr. Jack VanWoerkom
October 14, 2003
Page Two

companies to collect state and local taxes but not be eligible for the same tax benefits and subsidies than in-state companies receive?

- Would you favor a substantial reduction in the number of tax jurisdictions with which interstate retailers would have to contend?

In addition, questions from other Members of the Committee are attached. Your response to these questions will help inform subsequent action on this important topic. Please submit your written responses to these questions by 5:00 p.m. on Tuesday, October 28, 2003, to: Diane K. Taylor, Subcommittee on Commercial and Administrative Law, B353 Rayburn HOB, Washington, D.C. 20515. In addition, please provide your responses by e-mail to diane.taylor@mail.house.gov. If you have any questions, feel free to contact Diane K. Taylor at 202.225.2825. Thank you for your continued assistance.

Sincerely,

CHRIS CANNON
Chairman
Subcommittee on Commercial and Administrative Law

Enclosure

RESPONSES TO ADDITIONAL QUESTIONS BY MR. JACK VANWOERKOM

STAPLES

that was easy.

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October 31, 2003

The Honorable Chris Cannon
Chairman
Subcommittee on Commercial and Administrative Law
House Committee on the Judiciary
Attn: Diane Taylor
B353 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman,

On behalf of Staples, Inc. and Staples.com, I would like to thank you for holding the hearing on the Streamlined Sales Tax Agreement. As I stated in my testimony, Staples supports The Streamlined Sales and Use Tax Agreement and H.R. 3184, The Simplified Sales and Use Tax Act. Staples urges Congress to enact the Act to allow the simplification of state sales and use tax systems and provide a level playing field for all retailers. I am pleased to provide the following answers to the questions submitted by you and members of the Subcommittee on Commercial and Administrative Law.

- Would you support federal legislation on the subject of State sales taxes that included a provision requiring 100 percent state reimbursement of vendors for all of the reasonable administrative expenses they incur in the collection and remittance of State taxes?
  - Yes, Staples would support a provision requiring 100 percent state reimbursement of vendors for all of the reasonable administrative expenses they incur in the collection and remittance of State taxes. Many states currently reimburse businesses for a certain percentage of the expenses they incur in the collection and remittance of state sales taxes.
- Many municipalities have tax incentive programs available to shopping mall developers and various free government services designed to attract new development to their communities. These include TIF programs (Tax Incentive Financing), rebates of sales taxes, tax relief for hiring new employees, and even installation of infrastructure such as freeway exits, sewer lines, lighting, etc. Has Staples benefited from such programs?
  - Yes, Staples has benefited from such TIF programs.

- Out-of-state merchants are not eligible to participate in any of these government-sponsored benefits. Is it fair to ask Internet companies to collect state and local taxes but not be eligible for the same tax benefits and subsidies that in-state companies receive?
    - Yes, we believe it is fair. Staples and other brick-and-mortar retailers that receive incentives for locating in communities, also give back to those communities by creating jobs for local residents, contributing through charitable and civic involvement, and paying state and local taxes, including property and corporate income taxes, which in turn fund valuable services throughout the community.
    - By contrast, pure internet retailers do not invest in local communities, but they are afforded the benefits of local community services, such as roads, police and fire protections, and contract and other legal protections. Pure internet retailers may not benefit from TIF programs, but they already benefit from local community services.
- Would you favor a substantial reduction in the number of tax jurisdictions with which interstate retailers would have to contend?
    - The Streamlined Sales and Use Tax Agreement provides for only one tax rate per zip code. In terms of ensuring that it is easier for business to collect and remit sales taxes, one rate per zip code is actually preferable to a mere reduction in the number of tax jurisdictions. Because remote retailers already use zip codes to process and ship orders, we can easily determine the proper sales tax due by using a simple matrix displaying zip codes and product categories. It is an extraordinarily simple method for collecting and remitting sales tax. While we do favor a reduction in the number of tax jurisdictions, simply reducing the number of tax jurisdictions will not necessarily result in the significant simplification that one rate per zip code provides for interstate retailers.

QUESTIONS FOR ALL PANELISTS

- What privacy issues or concerns exist under the proposed Streamlined Sales Tax Agreement (SSTA) that do not exist for other types of remote sales?
    - Staples is a proud and committed leader in respecting the privacy of our consumers and providing privacy protections. We inform our consumers of their important privacy protections clearly on our website and apply such safeguards to all transactions whether online, in-store, or by mail-order catalog.
    - Neither the Streamlined Sales and Use Tax Agreement nor the Simplified Sales and Use Tax Act creates new privacy issues or concerns that do not already exist today with in-store or internet purchases. Additionally, all applicable federal and state privacy protections will apply to businesses and transactions under the simplified system as they do currently.
    - To reinforce the critical importance of confidentiality and privacy protections in this context, the Streamlined Sales and Use Tax Agreement contains valuable privacy protections, particularly with respect to the confidentiality and privacy requirements for certified service providers.

- Additionally, the Simplified Sales and Use Tax Act provides for "appropriate protections for consumer privacy" as one of the minimum simplification requirements (Sec. 6(13), H.R. 3184). The Act also states "privacy and confidentiality controls shall be placed on the multistate registration system so that it may not be used for any purpose other than the administration of sales and use taxes." (Sec. 6(1), H.R. 3184).

- What role does Congress have in insuring that the agreement includes privacy standards, auditing provisions and penalties for breach?
  - As noted above, the Agreement and the Act already provide for valuable privacy protections. Staples remains committed to strong confidentiality and privacy protections and encourages Congress to consider all appropriate privacy protections to safeguard the personal information of our consumers.

- If the States fail to include privacy standards in the agreement, should Congress also refuse to sanction the SSTA? Explain the rationale.
  - No. As stated above, the states have already included privacy standards in the Agreement, and H.R. 3184 includes privacy standards, which will apply to the Agreement and to the states. Further, Congress can add appropriate additional privacy standards to the legislation.

- What is the status of the SSTA certified software?
  - Staples has been using sales tax technology and software has been in existence for over twenty years, and is applied successfully by thousands of merchants in every industry. The applicable state and local tax rates are applied, the transaction is recorded, and tax liability information is inserted to the correct space on the applicable tax return.
  - It is our understanding that as states conform their states laws to the Streamlined Sales and Use Tax Agreement, software is in the process of being modified for consistency and uniformity. Currently states are developing testing and certification plans for the software. The software will then be certified by the Governing Board according to the requirements provided in the Agreement. (Sec. 501, SSUTA).

- There was testimony that the SSTA would increase offshore incorporation to avoid taxes. Is this a valid concern?
  - No. The costs of operating offshore will far offset any advantage the company is seeking by avoiding the responsibility of collecting sales taxes. For example, a company will face increased costs of customs, security, and shipping charges. Further, the company will have a reduced capability to provide products in the short-time period demanded by consumers and businesses in today's competitive marketplace.

- Is there or should there be a basis for providing access to the federal courts under the SSTA or H.R. 3184?

- H.R. 3184 already provides for judicial review in the United States Court of Federal Claims. H.R. 3184 provides that "The United States Court of Federal Claims shall have exclusive jurisdiction over actions for judicial review of determinations of the Governing Board of the Streamlined Sales and Use Tax Agreement." (Sec. 5, H.R. 1384)

- If the SSTA is not approved by Congress what cost-effective solutions would you propose to address State efforts to collect sales and use taxes?

  - The Streamlined Sales and Use Tax Agreement **is** the most cost-effective solution. The states have done an extraordinary job in creating this Agreement, and now Congress should enact the Simplified Sales and Use Tax Act. Without Congressional action to implement the Agreement, there is no other comparable cost-effective solution in the foreseeable future to simplify the states complex sales and use tax systems.

- Explain the advantages or disadvantages of the SSTA and provide your assessment of H.R. 3184.

  - There are many advantages to the Streamlined Sales and Use Tax Agreement, all of which are included in the federal legislation, H.R. 3184. Perhaps the greatest advantage of the Agreement is that it reflects a rigorous multi-year effort among states and businesses to make compliance relatively simple and reduce the cost and burden of collecting sales taxes, and yet still maintain state's rights and autonomy. The result is a balanced agreement that is helpful and efficient for both businesses and states.

  - For businesses, the Agreement provides uniform product definitions, one tax rate per zip code, affordable software, and other simplification features that will make the tax collection and remittance relatively easy for retailers.

    - Uniform Definitions: By providing for uniform product definitions, the Agreement eliminates the current confusion for consumers and retailers resulting from the exact same product being characterized differently by different states.

    - One rate per zip code: By providing for one rate per zip code, a retailer can easily calculate the sales tax rate, needing only to properly code the item and identify the zip code of the purchaser.
    - Affordable Software: Simplification software has been developed that will be available to retailers and will make compliance affordable and easy.

    - Additional Simplification Features: The Agreement also includes uniform audit procedures and a centralized state administration of local sales and use taxes to reduce (to one) the number of business sales tax filings in any state. Further, retailers will not be held liable if state-provided information, such as rates, boundaries, or zip codes, is incorrect.

  - Small Business Exemptions: Important for small business, the proposed legislation to implement the Agreement exempts businesses with less than $5 million in remote sales from collection responsibilities.

- For states, the Agreement leaves the critical decisions of what to tax, what not to tax, and the applicable tax rate for the states to determine.

  - State Decision to Tax or Exempt: States will continue to determine which items are taxable and which are tax exempt. For example, some states currently tax food, while others do not. The Agreement would not affect this differing treatment.

  - Tax Rates: States and localities will continue to determine their individual tax rates. The Agreement provides for one general tax rate per state (and a second rate on food and drugs), and a single local rate per jurisdiction – resulting in one rate per zip code. (The locality must still use the same tax base as the state, *e.g.*, if a state decides to exempt clothing, a local jurisdiction may not decide to tax clothing.)

- H.R. 3184 incorporates the simplification provisions of the Agreement and also provides important privacy provisions and federal judicial review.

Again, thank you for the opportunity to testify before the Subcommittee on Commercial and Administrative Law. I would be pleased to provide any further information you may require.

Sincerely,

Jack VanWoerkom
Executive Vice President, General Counsel
Staples, Inc.

PREPARED STATEMENT OF GROVER NORQUIST

Chairman Cannon and other members of this committee, thank you for the opportunity to address you regarding the Streamlined Sales Tax Project, or SSTP.

My name is Grover Norquist and I am president Americans For Tax Reform (ATR), a non-partisan, not-for-profit non-partisan coalition of taxpayers and taxpayer groups who oppose all federal and state tax increases. I submit my comments to you today in strong opposition to legislation that gives states that implement the Streamlined Sales Tax Proposal (SSTP) the authority to require remote sellers to collect sales and use taxes.

As numerous Governors and State Legislators faced large deficits due to the erroneous promises made by several state legislatures during the economic boom of the 1990s, many moved to cut spending and reign in government programs in an effort to balance their budgets. States such as Colorado have worked tirelessly to enact budgets that do not raise taxes or include consumption or use fees. However, several legislators believe that taxing Internet commerce is an acceptable solution to balance their budgets and create new revenue streams to expand government. Under the guise of providing competitive balance with main street businesses SSTP supporters have hoodwinked individuals and businesses into supporting this tax harmonization plan.

The SSTP is the first and essential step to create a stealth tax hike that would extend a national state sales tax to out-of-state Internet and other remote purchases, costing consumers hundreds of millions of dollars. Taxpayers expect that all pro-taxpayer lawmakers should oppose the creation of this tax and spend cartel.

Organizations that support the expansion and growth of government, such as the National Governors Association (NGA) and the National Council of State Legislatures (NCSL), strongly support the creation of a Streamlined Sales and Use Tax Agreement (SSTP). Supporters of the plan claim that the agreement, which has been entered into by 34 States, is merely an effort to allow states to participate in national discussions about how to "simplify" and "streamline" their sales and use tax system.

Proponents of SSTP include state tax commissioners and their staff, multi-state accounting firms, who stand to benefit from the compliance complexity SSTP induces, and tax-and-spend lawmakers desperate to ease the process of collecting taxes—so as to more easily increase taxes.

These organizations claim that if they don't tax the Internet, they will have to result to drastic measures to keep schools open, prisoners off the street, and the lights on in government buildings.

SSTP advocates tout the merits of a study by two professors at the University of Tennessee who concluded that state and local governments would collect over $440 billion in "new revenue" by expanding the sales tax to all Internet commerce, pushing their case for "tax simplification." However, these numbers are extraordinarily optimistic. Recent reports released by organizations such as the Direct Marketers Association refute these claims. Their studies cite revenue estimates of only $4.5 billion in increased tax revenue.

However, neither study takes into consideration the negative impact of extending sales taxes to include many currently untaxed online transactions. Since Internet sales only comprise 1.5% of all sales, a new tax will harm small online retailers and severely impact online economic growth and productivity. **In short, the SSTP attempts to create a new policy taxing a very small sector of the retail market and applies a regressive, overly punitive tax on online sellers and buyers.**

Additionally, supporters of the SSTP claim that it is not fair citizens must pay taxes on purchases in stores but not on purchases through catalogues or over the Internet. However, they do not honestly address the need for sellers to have a significant nexus in order to collect sales and use taxes. A bricks and mortar store collects tax on purchases in order to pay for services provided by the local government, including police and fire protection. **A customer that does not reside in that state or locality should not be forced to pay taxes for services he/she does not receive. This is the epitome of taxation without representation.**

Creating a harmonized sales tax code, to be applied to all Internet commerce, adds to the tax burden of the very "bricks and mortar" stores that SSTP supporters claim to protect. To succeed in an information-based economy, "bricks and mortar" or Main Street merchants have set up shops online and expanded their businesses to a universe of customers far beyond their immediate geographic locations. To implement a new sales tax collection system would require merchants to master the nation's every tax jurisdiction, adding to the already overwhelming tax burden of small businesses and hindering economic growth. Economic growth and business investment—not taxation—are the keys to improving the economy and creating new jobs.

Behind the scenes, the Streamlined Sales Tax Project is not benign. The SSTP movement has printed a national park's worth of paper about its benign intentions, but none of its operatives will attest to the net taxpayer impact of SSTP, now and in the future.

At its quarterly meetings, held in various geographic locations across the country to allow as many budget-constrained tax commissioners to attend as possible, SSTP planning committees debate various tax changes while members of the audience work to agree in consensus. Taxpayers—and most lawmakers—would have a hard time understanding many of the minutia discussed at these meetings. These minutias are precisely the problem; many tax code changes could make tax increases easier to implement and exemptions more difficult.

Implementing a sales tax in a state like Oregon would be much easier if the code is readily available and previously agreed upon by every state, or a majority of states.

For these reasons, every major free-market and pro-growth association opposes the SSTP. These groups include Americans for Tax Reform, the National Taxpayers Union, Citizens for a Sound Economy, Club for Growth, Citizens Against Government Waste, the Cato Institute, the Heritage Foundation, the American Enterprise Institute and dozens of state-based think tanks across the nation.

These groups oppose the adoption of the SSTP because the history of the movement does not support a commitment to tax neutrality, and because its present proponents cannot guarantee that the net impact on taxpayers in every state will be zero.

Increasing taxes should not be easy. All efforts to reform tax collection must ensure that competition among states and localities is protected and encouraged. Legislators must work to minimize impact of taxation to the greatest extent possible. Simplifying or streamlining the process is a very laudable goal and should be done to limit the paperwork and bureaucratic nonsense that taxpayers face each year when filing their taxes. However, a lawmaker's first priority should be to create a method that benefits taxpayers first and accounting firms second, while promoting economic growth and improving the efficiency of commerce.

I will address refute four of the 's seven goals outlined in "The Lawmaker;s Guide," subtitled "2003, The Year of Decision." This booklet is issued by the Multistate Tax Commission (MTC) to provide talking points and outline a plan for SSTP supporters to use when lobbying Congress, businesses, and other organizations to support the implementation of the SSTP. These four goals cause taxpayers to suffer directly and/or afford taxpayers no protection from future harassment. I will quote directly from the SSTP text and rebut.

STATE AUTOTONOMY

SSTP tax-and-spenders:

"Legislatures will choose what is taxable or exempt in their state. However, participating states will agree to use the common definitions for key items in the tax base and will not deviate from these definitions. As states move from their current definitions to the Projects definitions, a certain amount of impact on state revenues in inevitable. However, it is the intent of the Project to provide states with the ability to closely mirror their existing tax bases through common definitions." (Page ii, Lawmakers Guide: 2003).

Taxpayers rebut:

A good example of how the SSTP removes a state's autonomy to shape your own tax code and how the plan will harm taxpayers is provided by the changes Minnesota made to conform to the SSTP. Prior to adopting the SSTP, Minnesota imposed sales taxes only upon the price of each product purchased from a seller that had nexus in the state. The new SSTP definition of "sales tax" broadened Minnesota's sales tax to include shipping, handling, and postage. Now, thanks to the SSTP, the people of Minnesota pay a new tax on goods purchased outside the state, but the also get the added bonus of paying a higher price for goods bought from in-state vendors.

In the second sentence the SSTP booklet uses the term "key items" to explain how the plan will simplify the tax code by ensuring that each state applies an equal sales tax to these items. However, SSTP supporters do not define or clarify what the taxable "key items" are. In fact SSTP supporters have changed or manipulated the plan in order to gain the support of politically powerful states such as Texas and New York. Therefore, the stated goal that the plan will "simplify and streamline" the tax code is completely false.

In addition, MTC admits that the possibility of "impact" will occur when states implement SSTP tax code recommendations. Exemptions provide no long-term relief for taxpayers; adopting an exemption is more difficult than implementing the code in its entirety. Any effort to "reform" the tax code in each state must begin with the policy that the code will offset any possible tax increase by a dollar-for-dollar tax reduction.

It is clear, from this example, that supporters of the SSTP tax cartel are not up front or honest about the negative impact of extending sales taxes to include many currently untaxed online transactions.

RATE SIMPLIFICATION

SSTP Tax-and-spenders:

"States will be allowed one state rate and a second state rate in limited circumstances (food and drugs). Each local jurisdiction will be allowed one local rate. A state or local government may not choose to tax telecommunications services for example at one rate and all other items of tangible personal property or taxable services at another rate. State and local governments will accept responsibility for notice of rate and boundary changes at restricted times." (Page ii, lawmaker guide 2003).

Taxpayers rebut:

The booklet does not explain that allowing each state and local government to have their own tax rate compounds the current problem of tax simplification.

The free market, free enterprise movement has a long record of supporting fundamental tax reform and competitive tax jurisdictions. Rate simplification towards one flat rate is a commendable goal. The SSTP does not accomplish this objective!

If enacted the SSTP would force each merchant in the U.S. to collect a national sales tax. This means that a vendor would be forced to monitor and calculate up to 7,500 different tax rates on any and all sales. Furthermore, merchants would be responsible for determining each customer's nine-digit zip code, since many zip codes cross local jurisdictions.

The SSTP does not achieve simplification. In fact, the plan adds a new tax and regulatory burden on every business in America.

ADMINISTRATION OF ALL STATE AND LOCAL SALES AND USE TAXES

SSTP Tax-and-Spenders:

"Businesses will no longer file tax returns with each local government within which it conducts business in a state. Each state will provide a central point of administration for all state and local sales and use taxes and the distribution of the local taxes to the local governments. A state and its local governments will use common tax bases."

Taxpayers rebut:

Several states have looked at reducing compliance costs to reduce local jurisdictions' liability. Taxpayers' concern is that this will reduce competition between local jurisdictions to attract businesses and homeowners, and increase the likelihood of a tax cartel in which counties, cities, and towns are subject to the special interests of a central tax collector.

Taxpayers do not benefit from centralized power, when the purpose of that power is to collect and redistribute their tax dollars. For example, in Maine, some localities sent more tax dollars to Augusta than were returned to them, causing massive taxpayer dissatisfaction and eventual overturn of the law.

UNIFORM SOURCING RULES

SSTP Tax-and-spenders:

"The states will have uniform and simple rules how they will source transactions to state and local governments. The uniform rules will be destination/delivery based and uniform for tangible personal property, digital property, and services."

Taxpayers rebut:

A single entity responsible for all destination/delivery based transactions and resulting tax compliance in each state will create more bureaucracies to consume more taxpayer dollars. The same argument made against a single state tax collection agency can be made in opposing a central third-party tax collection agency. The central collection of all sales taxes again increases the likelihood of a tax cartel that will limit competition among states and ensures that individual states are subject to the special interests of a central tax-collecting agency.

Furthermore, defining source transactions to conform to a uniform definition will open a Pandora's box for privacy watchdogs. Authorizing a central tax collection agency to integrate the new SSTP created tax collection software into the business mainframe of every merchant in America raises numerous questions about the protection of consumer privacy. The central agency would have access to an individual's home address, phone number, financial information, and other pieces of information that are highly sensitive and confidential.

CONCLUSION:

The SSTP was created to implement a tax harmonization scheme that would allow states the authority to implement a predetermined and already-designed system for taxing consumers. Under the guise of tax simplification, SSTP supporters want to override a Supreme Court decision that prevents states from taxing interstate commerce without explicit Congressional permission. Thus creating a "stealth tax" that extends sales tax to currently untaxed products, services, and sales.

In addition, the plan forces state legislatures to cede important control over aspects of their state's sovereign tax system in deference to a national tax cartel. This is the first and essential step to implement a quiet tax hike and extend a national state sales tax to out-of-state Internet and other remote purchases, costing both buyers and sellers millions of dollars. In sum, the SSTP diminishes states from having the autonomy to shape their own tax policy, costs each state's economy jobs, and devastates their technology sector.

Americans for Tax Reform remains committed to defeating efforts to expand the scope of sales taxes and reducing current barriers to e-commerce.

LETTER FROM AND PREPARED STATEMENT OF MICHAEL J. TAVILLA AND STEVE DELBIANCO

October 8, 2003

Chairman Christopher Cannon
House Judiciary Subcommittee on Commerce and Administrative Law
B-353 Rayburn House Office Building
Washington, DC 20515

Mr. Chairman and members of the Committee:

I am Steve DelBianco, Executive Director of NetChoice, a coalition of e-Commerce retailers, technology companies, and trade associations committed to promoting commerce, convenience, and choice on the Net. I also serve as Vice President for Public Policy at the Association for Competitive Technology (ACT). On behalf of NetChoice, I would like to submit the following NetChoice report to include in the record of the Subcommittee's hearing on October 1st, 2003 regarding the Streamlined Sales Tax Agreement.

While NetChoice members vary in their products, they share a common desire to maintain the competitive nature of today's vibrant technology sector that has been responsible for a significant portion of American economic growth over the last decade.

It is my sincere honor to submit our testimony to the committee for the hearing that occurred and I appreciate greatly your interest in learning more about the Simplified Sales Tax Agreement and its potential effects on the economy and the e-commerce industry.

Thank you,

Steven Delbianco
Executive Director
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September 2003

NetChoice
Convenience
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Promoting Convenience, Choice, and Commerce on the Net

Sales Tax Simplification: *Not So Fast -- It's Not That Simple*

By Michael J. Tavilla, Steve DelBianco

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Sales Tax Simplification: *Not So Fast -- It's Not That Simple*

By Michael J. Tavilla, Steve DelBianco
September 2003

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About the Authors:

Michael J. Tavilla is Research Director for the Association for Competitive Technology (ACT), a founding member of NetChoice and a Washington-based, national education and advocacy group for the technology industry. Representing mostly small- and mid-sized companies, ACT is the industry's strongest voice when it comes to preserving competition and innovation in the high-tech sector. Prior to joining ACT, Michael was a Senior Research Associate on the Internet Policy & Regulation Research Team at Forrester Research in Cambridge, Massachusetts.

Steve DelBianco is Executive Director of NetChoice, a coalition of e-commerce retailers, technology companies, and trade associations committed to promoting commerce, convenience, and choice on the Net. Steve also serves as Vice President for Public Policy at the Association for Competitive Technology (ACT). Prior to joining ACT, Steve was founder and president of a software consulting firm that grew to several U.S. locations before being acquired.

NetChoice is a coalition of trade associations, e-commerce businesses, and online consumers, all of whom share the goal of promoting convenience, choice and commerce on the Net. Founding members include The Association for Competitive Technology (ACT), the Information Technology Association of America (ITAA), the Electronic Retailing Association, Orbitz, eBay, and eRealty.

Executive Summary

State governments have long grappled with the challenges of collecting sales and use tax on purchases from out-of-state retailers. Mail-order catalog sales, telephone, and most recently, Internet commerce have all presented a challenge to state tax administrators seeking to tax, with e-commerce being just the latest iteration of a decades old concern. The 1992 Quill decision by the US Supreme Court upheld the premise of "nexus", such that only businesses with a physical presence in a state can be forced to collect sales taxes for that state. State governments are hoping to overcome the nexus requirement by simplifying and streamlining their tax codes, and are now seeking a Congressional mandate to ensure compliance by retailers nationwide.

Currently, players in the debate can be categorized into six groups: catalog retailers; Internet-only retailers; multi-state/multi-channel retailers; business-to-business services and retail; "Main Street" retailers; and state and local governments. Each has a unique perspective and predictably different opinion of the sales tax simplification project.

Calls for greater taxing authority have come to a head in recent years as the dot-com bubble burst, the US economy entered recession, and states faced huge revenue shortfalls. States forecast an aggregate revenue gap between $40 and $70 billion annually and they cite taxes lost to e-commerce as a primary reason. They argue that remote retail shifts the responsibility of tax remittance to buyers paying their use taxes, where business compliance is nearly universal, but consumer compliance is rare. States add that remote catalogs and e-commerce are hurting "Main Street" retailers who are collecting sales tax on every purchase.

Complicating the debate are vastly different estimates of lost tax revenue as a result of e-commerce sales. For example, a University of Tennessee study and a more recent study by the Direct Marketing Association (DMA) cited losses of $26.2 billion and $2.5 billion for the year 2003, respectively. These estimates have provided the ammunition that all players in the debate have cited to either spur or stifle Congressional action. As of 2003, the Streamlined Sales Tax Project (SSTP), the three year old multi-state effort to achieve uniformity in state tax codes, has surpassed its adoption milestone. While several large, multi-channel retailers have started collecting tax on all remote purchases, it's going to take a federal mandate to force retailers everywhere to collect remote sales tax. Governors and legislatures have pressured lawmakers in Washington for this power, citing the progress of the SSTP and the urgency of states in financial distress.

In reality, states will realize just a fraction of their oft-cited projections of uncollected sales taxes. Growth in e-commerce has cannibalized catalog and phone order sales, which have never been widely taxed and have not had the anticipated devastating effect on "Main Street" retailers. In addition, the SSTP lacks the clarity necessary for tax fairness and favors tax collection authority over the interests of Web retailers and consumers. Ambiguity surrounding taxable goods, intra- and inter-state battles around participation in the Project, and the unresolved issues of business activity taxes all mean the SSTP's real simplicity, fairness, and viability are far from certain.

The compliance costs of SSTP -- especially for small firms -- could well outweigh the probable benefits of taxing all remote purchases. States can recoup some lost revenue and help make-up budget shortfalls with more aggressive pursuit of multi-channel, multi-state retailers and greater use tax enforcement, without a federal mandate imposed on all inter-state retailers.

Introduction

Congress and the states are both moving to force catalog and Internet retailers to collect sales tax on out-of-state, usually defined as "remote," purchases. States have protested for decades about lost revenue from catalog and other remote sellers, but the Supreme Court has consistently ruled that the burden of collecting for numerous jurisdictions is simply too onerous to saddle upon retailers and too detrimental to interstate commerce. In response, a coalition of states has promised to simplify their sales and use tax systems and have asked Congress to endorse their plan. But remote sales tax collection will be anything but simple -- especially for small businesses -- and states won't realize anywhere near the dollars they anticipate.

The Landscape

Born out of Depression-era desperation for local revenue and a wider tax base, Mississippi became the first state to impose a sales tax during the 1930's. The initial tax rate in Mississippi was 1%, whereas current sales tax rates average 6% in nearly 7,500 taxing jurisdictions nationwide.

Today, multiple players with different motivations have joined in the sales tax debate. While most arguments are decades old, the debate has been reenergized by the recent growth of interstate e-commerce. The NetChoice Coalition categorizes the players in the remote sale tax debate into six (6) groups (See Figure 1):

1) **Catalog retailers.** Starting in the 1870's when Aaron Montgomery Ward sent his first catalog and started America's first mail-order business, catalog retailers have been selling to out-of-state buyers -- without having to collect sales tax.[1] The US Supreme Court decision in Quill Corp. v. North Dakota (1992), handed down before widespread use of the Internet, addressed the issue of catalog sales and upheld the nexus requirement.[2] Much of the initial growth in e-commerce came from catalog buyers going online, where remote sales were also largely untaxed. This is indicative of a high convergence between Web and catalog retailers, according to the Direct Marketing Association (DMA), since almost all catalog retailers (97%) have an active Internet presence and one quarter have had a Web site for more than four years. Virtually all catalogers (95%) described their business as multi-channel retail. They were closely split between having an integrated catalog/Internet (50%) operation, or catalog/Internet/in-store retail (45%).[3]

2) **Internet-only retailers (both large and small).** Large players include such marquis dot-com survivors as Amazon and Dell. This group has no bricks-and-mortar retail outlets, but relies completely on e-commerce to bring their wares to market. Small Web-only retailers are usually start-up, entrepreneurial firms or often those dealing in specialized items. Nexus for this class of firms occurs only in states where they have physical operations, including distribution centers.

3) **Multi-state, multi-channel "big-box" retailers.** Typified by highly branded retail giants like BestBuy, Home Depot, and Wal-Mart, this class of retailer has physical presence in many states, where their stores have been collecting sales taxes all along. In addition, these retailers now offer robust and popular Web outlets that are increasingly integrated with their offline counterparts to extend the brand and to offer customers the greater convenience of a clicks-and-mortar experience. Purchases from these websites are therefore subject to the same sales tax collection rules that apply to their physical stores, so many of these retailers are "voluntarily" collecting

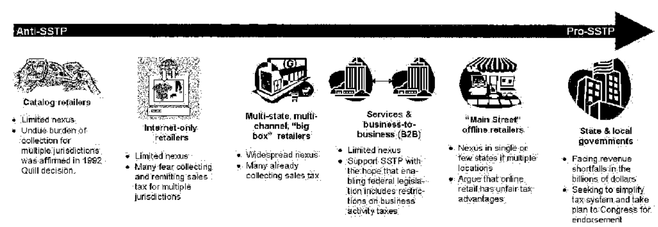
sales tax on Internet purchases as well. Their recent decisions to begin collecting remote sales tax were prompted in part by several states offering amnesty for previously uncollected taxes. All things considered, today's debate concerning new obligations to collect remote sales tax is unrelated to the situation of these multi-channel, multi-state retailers since they already have nexus and have started collecting tax independently of any mandate.

4) **Business-to-business services and retailers**. This group is comprised of manufacturing, consulting, legal, advertising, equipment leasing, and other business-to-business suppliers. They sell at the wholesale level, or provide raw materials and services that aren't widely subject to sales tax. But they do sell into many states, and want to minimize what they pay in income taxes and other business activity taxes (BAT) levied by states. These companies have generally supported SSTP, hoping that enabling federal legislation would include new restrictions on states' ability to collect BAT.

5) **"Main Street," offline retailers.** This group is comprised of typical bricks-and-mortar retailers with a single or perhaps several localized locations. Main street retailers have clamored for "tax fairness", arguing that customers buy from out-of-state Web sites and catalogs *just* to avoid paying sales tax.

6) **State and local governments.** States have long sought to recoup uncollected sales taxes on out of state purchases, but the threat of increased e-commerce has given them new resolve. Organizing forces under the flag of the National Conference of State Legislatures, (NCSL), they launched the multi-state Streamlined Sales Tax Project in early 2000 and are currently asking Congress to force remote sellers to collect sales taxes, claiming that their SSTP plan "radically simplifies sales and use taxes."[4]

Figure 1: **Sales Tax Players Comprise Six Groups**



Source: The NetChoice Coalition

THE SALES TAX POT RETURNS TO A BOIL, AGAIN.
From their Depression-era introduction through to present day, the sales tax has always been a contentious pull-and-tug between retailers, tax commissioners, and consumers. E-commerce merely injects new life into the debate by filling tax administrators with the fear that even more tax revenue will escape into the ether of the Internet. After years of study and argument, the remote sales tax issue has come to a head, with calls for a national solution growing louder as:

- **Governments cite growing budget shortfalls, point to e-commerce as the scapegoat.** According to the National Governor's Association (NGA), state budget deficits for 2002 totaled between $40 billion to $50 billion. Governors and revenue commissioners point to e-commerce as a significant contributing cause of this financial condition and argue that greater sales tax collection power will give states much-needed relief. State legislators also link e-commerce and revenue shortfalls to spending cuts in bread-and-butter services like education and public safety.

- **Businesses pay their use tax on nearly all taxable remote purchases.** It's widely acknowledged that there is little uncollected sales and use tax on purchases made *by businesses*. State tax commissioners have long realized that the detailed purchasing records kept by businesses are easy to audit for computing use tax on out-of-state purchases. More importantly, businesses have learned that sales tax audit programs are extensive -- and that penalties and interest are expensive. Consequently, nearly all businesses comply by filing and paying use tax on their taxable purchases, whether from in-state or remote vendors, and whether from catalogs or websites. The March 2003 study by the DMA estimated use tax compliance for B2B sales at 85% while an earlier June 2000 report by the US General Accounting Office (GAO) estimated tax compliance rate at a whopping 95%.[5]

- **But consumers rarely pay their use tax.** Any collection of consumers' use tax has been spotty at best, hampered by taxpayer ignorance of the liability, administrative difficulties in tracking out-of-state purchases, and, more recently, public misconceptions about taxes and the Internet. Revenue officials admit that enforcement efforts are virtually nonexistent, and that they rely heavily on community notification and voluntary tax compliance. Whether because of honest ignorance or willful disregard of use tax laws, this approach generally has been a failure. The State of Florida, for example, found that despite efforts in recent years to get the word out about its use tax, only 1,813 people --mostly Florida Department of Revenue employees -- filed and paid use taxes. But modest successes have been realized. North Carolina reported that when it added the use tax line to returns in the year 2000, it yielded $4.9 million, dwarfing the mere $125,000 in use taxes collected the prior year. Michigan, too, saw its use tax collection shoot up. Michigan's treasurer reported more than 62,000 people declared and paid use taxes in 2000, up from only 2,500 the year before, netting the state an extra $2 million.[6]

- **Widely different estimates of actual and potential uncollected sales tax.** The US General Accounting Office (GAO) estimated that state and local sales and use tax losses from remote sales (both Internet and catalog) for the year 2000 ranged from $1.6 billion to $9.1 billion, depending upon the assumptions applied. State and local sales tax losses for 2003 were estimated to range between $2.5 billion to $20.4 billion, again depending upon the assumptions applied. The University of Tennessee Center for Business and Economic Research estimated in 2000 that sales and use tax losses attributable to Internet sales would grow from $1.23 billion in 1999 to $10.8 billion in 2003. However, these figures did not include lost revenue from catalog mail order sales. A study by Forrester Research -- which included only business-to-consumer sales, not business-to-business sales -- estimated that sales and use tax revenue losses from Internet sales were $525 million in 1999. As with the University of Tennessee estimate, the figure did not include lost revenue from mail order sales.[7] More recently, the Direct Marketing Association (DMA) estimated much more modest tax losses from e-commerce sales amounting to only $1.9 billion in 2001 and $4.5 billion by 2011.[8]

- **Streamlined Sales Tax Project (SSTP) reaches milestone.** The SSTP was begun in early 2000 as a multi-state effort to simplify and bring uniformity to sales and use tax. As of mid-2003, twenty states -- representing about one-third of the population of the forty-one states participating in the SSTP -- have enacted the model legislation, double the ten state minimum agreed to by the project. Now members of the coalition SSTP have now turned their attention to Congress, asking for a federal mandate to force sellers to collect sales tax on out-of-state sales.

- **Big-box retailers with affiliated websites have started collecting tax.** In February 2003, a handful of large, national retailers started voluntarily collecting sales tax. Online sales tax advocates point to this evidence that collection is in fact possible and not an undue burden to business. Rather than to quell complaining tax commissioners, this is more an effort to satisfy the needs of the burgeoning multi-channel consumer, where the worlds of on- and off- line converge, allowing for conveniences such as in-store returns or pick-ups of items purchased online. In addition, these big players may have also started collecting sales tax on web sales when states asserting nexus offered them amnesty for previously uncollected taxes.

- **Federal government tentative, still contemplating policy moves.** Congress decided in the summer of 2003 to separate the related (and widely misunderstood) issues of Internet access tax and Internet sales tax. While it's a lock that Congress will ban taxes on Internet access charges, they are still being pressured from all sides on the sales tax front. From small "Main Street" retailers begging for parity with their equally small online counterparts, to struggling tax commissioners, to trade associations on both sides -- all have descended upon Washington to stir -- or stall -- Congressional action.

Analysis

- **Taxing Internet sales will NOT solve state budgetary woes.** Advocates of a sales tax collection mandate have relied upon a flawed University of Tennessee study whose potential revenue estimates from Internet tax collection are ten times too high. Why? The Tennessee professors showed the effects of "Internet exuberance" by forecasting e-commerce growth of 40% per year, when actual growth has been a more modest 12%. In the Tennessee study, Internet commerce was said to include commercial manufacturing shipments and other B2B sales transacted via Electronic Data Interchange (EDI). Taxes on EDI transactions are already captured by states via the near total business compliance with use tax filing requirements. New US Commerce Department data show that even in the peak Internet boom year of 2000, EDI accounted for 95% of manufacturers' dollar shipments, leaving only 5% transacted over the Internet. Generally, the DMA forecasts of taxes lost to Internet commerce are just one-tenth as high as the Tennessee forecasts (See Figure 2).

Figure 2: Comparison of University of Tennessee vs. DMA/US Census Bureau Data: Uncollected State and Local Tax Arising From Internet Growth ($ millions)

	2003		2006		2011	
State	**U-Tennessee**	**DMA**	**U-Tennessee**	**DMA**	**U-Tennessee**	**DMA**
Alabama	$349.6	$33.4	$604.3	$42.7	$734.4	$60.3
Arkansas	$283.4	$27.0	$488.0	$34.6	$590.9	$48.5
Arizona	$455.5	$43.5	$799.2	$55.6	$982.5	$80.6
California	$3,449.2	$329.1	$5,952.0	$421.3	$7,225.0	$592.8
Colorado	$395.6	$37.7	$686.4	$48.3	$836.2	$68.6
Connecticut	$375.5	$35.8	$648.9	$45.9	$788.2	$64.7
D.C.	$72.3	$6.9	$123.1	$8.8	$147.7	$12.1
Florida	$1,837.3	$175.3	$3,214.0	$224.4	$3,944.4	$323.6
Georgia	$865.2	$82.6	$1,517.8	$105.7	$1,865.6	$153.1
Hawaii	$207.1	$19.8	$359.2	$25.3	$438.3	$36.0
Iowa	$220.4	$21.0	$372.3	$26.9	$443.7	$36.4
Idaho	$87.5	$8.4	$151.5	$10.7	$184.6	$15.1
Illinois	$1,050.3	$100.2	$1,795.3	$128.3	$2,161.7	$177.4
Indiana	$424.7	$40.5	$728.5	$51.9	$879.8	$72.2
Kansas	$264.9	$25.3	$451.5	$32.4	$542.2	$44.5
Kentucky	$312.8	$29.8	$535.5	$38.2	$645.8	$53.0
Louisiana	$596.4	$56.9	$1,008.1	$72.8	$1,202.5	$98.7
Massachusetts	$395.4	$37.7	$683.0	$48.3	$828.6	$68.0
Maryland	$383.2	$36.6	$664.3	$46.8	$809.2	$66.4
Maine	$84.9	$8.1	$146.4	$10.4	$177.5	$14.6
Michigan	$991.2	$94.6	$1,696.2	$121.1	$2,043.6	$167.7
Minnesota	$533.3	$50.9	$920.6	$65.1	$1,117.2	$91.7
Missouri	$515.6	$49.2	$884.1	$63.0	$1,066.7	$87.5
Mississippi	$269.0	$25.7	$462.8	$32.9	$560.0	$45.9
North Carolina	$578.3	$55.2	$1,010.9	$70.6	$1,239.4	$101.7
North Dakota	$52.0	$5.0	$87.6	$6.4	$103.9	$8.5
Nebraska	$139.7	$13.3	$238.7	$17.1	$287.3	$23.6
New Jersey	$665.8	$63.5	$1,150.0	$81.3	$1,396.1	$114.5
New Mexico	$254.4	$24.3	$440.2	$31.1	$535.4	$43.9
Nevada	$248.9	$23.8	$441.7	$30.4	$549.0	$45.0
New York	$2,075.2	$198.0	$3,569.2	$253.5	$4,318.4	$354.3
Ohio	$880.4	$84.0	$1,502.2	$107.5	$1,805.9	$148.2
Oklahoma	$399.7	$38.1	$670.6	$48.8	$794.5	$65.2
Pennsylvania	$879.8	$84.0	$1,503.4	$107.5	$1,811.0	$148.6
Rhode Island	$72.5	$6.9	$124.5	$8.9	$150.4	$12.3
South Carolina	$302.3	$28.8	$525.0	$36.9	$640.5	$52.5
South Dakota	$77.7	$7.4	$133.4	$9.5	$161.3	$13.2
Tennessee	$714.1	$68.1	$1,242.8	$87.2	$1,518.7	$124.6
Texas	$2,290.4	$218.6	$3,957.0	$279.7	$4,805.6	$394.3
Utah	$206.0	$19.7	$359.0	$25.2	$439.2	$36.0
Virginia	$470.1	$44.9	$817.0	$57.4	$997.2	$81.8
Vermont	$41.4	$3.9	$71.7	$5.1	$87.2	$7.2
Washington	$820.9	$78.3	$1,427.3	$100.3	$1,745.3	$143.2
Wisconsin	$420.8	$40.2	$721.5	$51.4	$871.0	$71.5
West Virginia	$138.2	$13.2	$232.4	$16.9	$276.2	$22.7
Wyoming	$51.4	$4.9	$85.2	$6.3	$100.0	$8.2
TOTAL	**$26,200.0**	**$2,500.0**	**$45,204.3**	**$3,200.0**	**$54,849.5**	**$4,500.0**

Source: The Direct Marketing Association

- **Clarity still lagging under the SSTP.** Even tax officials have expressed doubt as to the simplicity and workability of the SSTP. In a research study where twenty-seven state tax commissioners were interviewed, doubts were raised by these administrators that the SSTP would ever be successful. One tax official was quoted as saying, "We'll never get every one of those states to standardize, never mind the numerous local tax authorities. We'll never get the uniformity necessary to make it work."[9]

- **SSTP ambiguity favors tax commissioners, not consumers and not retailers.** The SSTP's July 2003 "*Digital Equivalent of Tangible Personal Property Issue Paper*" attempts to equalize sales tax treatment of digital and tangible personal property. In situations where a digital good or service has no approximate tangible equivalent, tax commissioners could determine whether the item "would be" taxable, without any legislative action. State legislators, who signed on to SSTP to reduce complexity and help "Main Street" businesses, might be surprised when angry constituents complain that SSTP has effectively enacted new taxes on new kinds of goods and services.

- **The Internet isn't a tax-free zone -- and <u>nowhere</u> else is either.** Purchases made by any other means other than traditional offline retailers, including catalog, phone, or Internet, are not tax free just because they are made remotely. Consumers residing in sales tax states who make purchases out-of-state are bound by law to remit use taxes to their local jurisdiction, usually via a line item on their annual state income tax return. Even in the five states with no statewide sales tax rate, Alaska, Delaware, Montana, New Hampshire, and Oregon, localities are still allowed to collect tax. For example, in Alaska, where the state has no sales tax, the cities of Bethel, Clarks Point, and Dillingham each charge their own 5% sales tax.[10]

- **The online consumer is <u>not</u> seeking a tax shelter by spending online**. Shipping costs are generally greater than any sales taxes saved on the average online purchase. It's clear that consumers buy from catalogs and Web sites because of better selection, more information, convenience and lower prices -- not to evade paying sales tax. According to a recent Forrester Research study, "Despite their mild protestations about paying a little more per online purchase, people don't buy online just to save a few tax dollars." [11]

- **Yet even the minority of persistent tax evaders will always be so**. As stated earlier, the bulk of online consumers say they're shopping online for convenience, value, and choice -- not to save avoid paying sales tax. Still, there are undoubtedly some who seek sales tax savings by ordering out-of-state for high-price, low shipping weight products such as digital cameras, camcorders, and other similar consumer electronics. If a collection mandate were imposed on all US retailers, tax-motivated purchasers could still avoid sales tax simply by re-directing their browser or placing a toll-free call to a non-US retailer. While not enough to drive sales to overseas retailers given prohibitive shipping costs, the SSTP could harm US e-commerce players by driving tax-averse buyers to use catalogs or Web sites located in Canada and Latin America.

- **Some states and cities may stay off the SSTP bandwagon.** States without sales tax, such as New Hampshire and Delaware, have little incentive to embrace SSTP. Further, some intra-state battles are brewing between cities and regions of the same state with different tax rates or varying mixes of retailers and consumers. Businesses in Kansas cried foul when they were mandated in July 2003 to collect and file taxes on delivered items to each of the state's 751 taxing jurisdictions. Recently, a leading business group in Virginia suggested that by opting-out of the SSTP collection mandate, the state could achieve a competitive advantage in attracting Internet retailers and technology firms.

- **Tilting the playing field against catalog and Internet retailers.** Currently, both online and offline retailers have to maintain processes and systems for one state, so they share an equivalent collection burden. In other words, when comparing the burdens of tax collection and filing, the playing field *is already level*. Under the SSTP remote tax collection plan, bricks-and-mortar retailers would still collect and remit for only one locality, while catalog and online retailers would have to collect for 50 taxing authorities on the low end and several thousand on the high-end. This will clearly make for a higher burden for some retailers and not for others -- a playing field that's ultimately stacked against remote sellers. Proponents of the SSTP issued a request for proposal in early 2002 for a cost study but the research is just underway and there is no reliable data about forecasted compliance costs.

- **The costs of collection will be significant, even after "simplification".** SSTP advocates promise to offer free tax software to assist with computing sales tax and filing with thousands of jurisdictions. While it's true that a shopping cart website will benefit from a state-certified tax calculation tool, the real complexity and costs of retail information systems are in handling what goes on behind the Web site. That is, the back-office staff and systems to process partial orders, exchanges, returns, and credits. It's therefore likely that the state-supported tax software won't agree with the retailers' back end systems when figuring the taxes due to each jurisdiction. Some retailers may make the investments to modify their back-end systems to obtain SSTP certification, but they're still going to have to file and remit to each jurisdiction. Thus far, the SSTP debate has been over-simplified in describing the costs of collection and compliance. That's going to change as remote retailers -- especially small businesses -- get a closer look at the SSTP legislation and requirements.

- **Internet retail draws customers from mostly untaxed catalog sales rather than brick-and-mortar outlets.** Catalog sales to consumers, on which states had rarely collected sales tax, represent four times the amount of uncollected tax from Internet sales today. And a study authored by experts at the University of Chicago and Harvard Business School concluded that e-commerce predominantly cannibalizes catalog sales and isn't the great assault on bricks-and-mortar outlets that some have argued.[12]

- **Internet retail doesn't just shuffle trade around, but <u>creates</u> commerce as well.** The Internet has made possible new business models and *created* trade, not just diverted commerce activity from offline sources. A prime example of this is the PC market, where direct manufacturer-to-consumer sales have yielded sales that most likely would never have occurred were it not for the Net.[13] Internet retail also provides other, new-found taxing benefits for home states. The sales tax debate shouldn't be used to pit online and offline businesses against each other, since more and more businesses are using e-commerce as a critical distribution channel. Thousands of bricks-and-mortar retailers have published catalogs and created web sites to reach new customers, driving incremental sales and paying additional business taxes in their home states

- **Excess baggage could weigh-down the SSTP train.** Large retailers, manufacturers, and service businesses operating in multiple states have long sought protection from aggressive state tax commissioners, who claim portions of corporate income tax and other business activity taxes (BAT). While the SSTP has no direct bearing on business activity taxes, large businesses interests want some BAT "protection" measures in any SSTP legislation that moves in Congress. However, the National Conference of State Legislators (NCSL) considers any new limitations on BAT too high a price to pay for a federal mandate to collect sales tax. This is a subtle but serious point of contention that could slow SSTP's momentum in Congress.

Conclusions

In sum, the SSTP and related debates surrounding modern commerce have highlighted the shortcomings and need for reform in the way tax is collected and remitted in an interconnected economy. That said, the proper balance must be struck to achieve tax parity and ultimately tax fairness between on- and off- line business, large and small. As such, any effort should contemplate the following to reach an economically balanced and rational resolution:

- **States should assert nexus where out-of-state Web sites and catalogs already have affiliated physical locations in their states.** States should continue pursuing large, multi-channel, multi-state retailers, building on the success of voluntary tax collection by the biggest of retailers in early 2003. And states can start now as they don't need any blessing from Congress to do this.

- **Firms that have minimal taxable sales to out-of-state customers should be exempt from a collection mandate.** Firms with small amounts of interstate, taxable sales shouldn't be saddled with the burden of collecting sales tax for other states and localities. The costs of collection, filing, and remittance don't justify the incremental revenue that would come from their consumers (recall that business customers already have very high compliance with use tax remittance on all their purchases).

- **Don't eliminate tax competition among the states.** It's fundamental to the notion of federalism that states compete with each other to attract businesses and consumers. Not surprisingly, much of that competition is based on distinctions in state tax policies. A federal mandate on collecting sales tax takes away some of the options for state tax competition. An alternative approach would be to let a state opt-out of both sides of SSTP -- they might give up the extra tax revenue on out-of-state purchases, while businesses in their state would be exempted from collecting other states' sales taxes.

- **More aggressive use tax enforcement.** Although never apt to be the solitary means to ensure tax fairness, the existing use tax scheme should be considered as a complementary way to help recoup tax revenue. As noted earlier, some success has been realized when consumers are educated about the tax, with as little as adding a line item to an income tax form, rather than burdening consumers with seeking out separate paperwork or forms. More importantly, this is possible without seeking a Congressional mandate.

- **If and when legislating, Congress shouldn't forget to establish mechanisms where states are encouraged to pursue use tax more stridently and encourage states to keep their financial houses in order.** Congress shouldn't forget what helped put states in this financial condition in the first place, over-spending and over-committing during the boom. E-commerce shouldn't be the only means to bail-out cash-strapped states from the overspending many states engaged in during the flush times of the late 1990's.

- **If and when Congress gives states the mandate they seek, it should require that states work to erode barriers to e-commerce.** The last decade has seen seismic shifts in the way businesses get products to market and the way consumers research and purchase; and the lines between on- and off-line retail have blurred. Yet astonishingly, in certain instances, e-commerce firms are held to entirely different rules by state regulators and incumbent industry interests. For example, in some states contact lens wearers are denied access to their prescriptions, barring them from sometimes lower cost and more convenient Web retailers, leaving them no other option than purchasing their lenses from their opticians. These barriers are steeped in legacy rules and protectionist postures by states, clinging to old economy distribution models that limit choice and convenience for consumers.

Barriers to free and easy commerce over new channels are forecast to cost US consumers over $36 billion in 2003 alone and over $48 billion for the year 2006.[14] A leading Democratic think-tank in Washington is advocating that Congress should ask states to remove barriers to e-commerce in exchange for the sales tax mandate they seek.[15]

Endnotes

[1] Aaron Montgomery Ward sent out his first mail order catalog in 1872 - for his Montgomery Ward mail order business located at Clark and Kinzie Streets in Chicago. The first catalog consisted of a single sheet of paper with a price list, 8 by 12 inches, showing the merchandise for sale with ordering instructions. (*Source:* The Chicago Public Library)
[2] Under North Dakota law, Quill Corp. was required to collect taxes from state residents, even though Quill had no physical presence there. The Court overturned the law -- ruling that Quill was not obligated to remit use taxes because it lacked nexus in North Dakota. The opinion also recommended that Congress act to remedy the lack of clarity surrounding tax collection on remote sales.
[3] The State of The Catalog Industry Report 2001, The Direct Marketing Association.
[4] The Streamlined Sales Tax Project (SSTP), www.geocities.com/streamlined2000.
[5] Johnson, Peter A., "*A Current Calculation of Uncollected Sales Tax Arising From Internet Growth,*" March 11, 2003; and "*Sales Taxes: Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain,*" General Accounting Office, June 2000.
[6] www.bankrate.com
[7] The US General Accounting Office (GAO), Forrester Research, KPMG e-tax News flash, August 2001.
[8] Johnson, Peter A., "*A Current Calculation of Uncollected Sales Tax Arising From Internet Growth,*" March 11, 2003.
[9] Sharrard, J., McCarthy, J., Tavilla, M., The Forrester Report "*Making Net Sales Tax Pay,*" November 2000.
[10] The Sales Tax Clearinghouse.
[11] The Forrester Research Brief, "*The Internet Taxman Cometh – Who Cares?,*" February 7, 2003.
[12] Goolsbee, A. and Zittrain, J., "*Evaluating the Costs and Benefits of Taxing Internet Commerce,*" 1999.
[13] Ibid.
[14] DelBianco, S. & Tavilla, M., "*The State of eCommerce 2002: Beyond the Bubble, Beware the Barriers,*" The NetChoice Coalition, October 2002.
[15] Atkinson, R., "*Leveling the E-Commerce Playing Field: Ensuring Tax and Regulatory Fairness for Online and Offline Businesses,*" The Progressive Policy Institute (PPI), June 30, 2003.

Letter from Karin Brownlee

Congressman F. James Sensenbrenner
U.S. House of Representatives
B-353 Rayburn HOB
Washington, DC 20015.

RE: Streamlined Sales Tax Project

Dear Congressman Sensenbrenner:

Kansas passed legislation in the waning hours of the 2003 session bringing us into compliance with the Streamlined Sales Tax agreement. The bill passed in early May with an effective date of 7-1-03. The short time frame for Kansas businesses has been quite difficult but more importantly, the content of the legislation has proven to be extremely burdensome.

Prior to this legislation, Kansas collected sales tax on an origin of sale based system. This tends to work well with our 751 different taxing jurisdictions. HB 2005 made the sweeping change of converting the state to destination based collection of sales tax. Our many taxing jurisdictions reflects the importance of home rule to our cities and counties who have the ability to raise sales tax for defined purposes.

With the difficult budget challenges that we have had in recent years, the Legislature has made changes such as tax increases of various types that are not favorable towards business. However, this change to destination sourcing due to an attempt to comply with SSTP has prompted a tremendous outcry from Kansas businesses. Their message has been one of "this is impossible, we cannot comply with this." We are asking our businesses to do the job that government is charged with doing, that of distributing and collecting taxes. Businesses need to focus on being productive, not on doing the job of the government if we are to have any hope of growing out of this recession.

The SSTP seems to pit small businesses against big businesses. A number of big businesses have clearly had a physical presence in Kansas but have declared their Internet sales as a separate subsidiary located in another state so that they were not subject to Kansas sales tax. This nexus issue seems to be at the crux of this argument and is likely the better place to solve the issue of how to collect sales tax on Internet sales (or remote sales in general). These large businesses then compete head to head with Kansas small businesses who also sell over the Internet but do collect Kansas sales tax.

As an individual state, we have attempted to close this nexus loop hole in our tax policy. This should lead us on the path to collecting Kansas sales tax from such companies as Walmart.com and others who are clearly present in our state.

Should Congress pursue the idea of SSTP, I would question if this would cause an undue burden on business to comply with the nearly eight thousand taxing jurisdictions in our country. As stated earlier, the agreement seems to favor big businesses who would have a greater capability of collecting sales tax in this complicated manner. A small business that may be quite computer savvy would have a much tougher time financing a computer system that could intelligently know the tax jurisdiction to which an order might be shipped.

Finally, the streamlined sales tax project is anything but streamlined. Although the goal may have been to simplify sales tax, the target that has been hit with the current agreement is one of uniformity. We would be better off to continue to write tax policy as Kansans see fit rather than trying to comply with a voluntary national project that takes away much of our decision making ability on tax policy.

Thank you for your interest in this topic. I hope that your office and committee staff will stay in touch with myself and others in Kansas as this issue continues to develop.

Sincerely,

State Senator Karin Brownlee
14725 S Chalet Dr
Olathe, KS 66062
913-782-4796
brownlee@ink.org

copy - Congressman Dennis Moore

LETTER FROM KENNETH DANIEL

MIDWAY WHOLESALE
P.O. Box 1246
Topeka KS 66601-1246

October 7, 2003

Rep. Chris Cannon, Subcommittee Chairman
Judiciary Committee, U. S. House of Representatives
B-353 Rayburn House Office Building
Washington, DC 20015

Dear Chairman Cannon and Members of the Committee:

My business, Midway Wholesale, is a specialty building materials wholesaler with seven branches in Kansas. In addition, I am the Chairman of the Kansas Leadership Council of NFIB. The purpose of this letter is express my deep concern, both for my own business and for thousands of NFIB members in Kansas, with the "destination sourcing" provisions of the Streamlined Sales Tax Project.

In April, the Kansas legislature passed legislation to bring the state into conformance with the Streamlined Sales Tax Project, effective July 1. It pains me to inform you that the "destination sourcing" provisions of this law are perhaps the most damaging legislation to small business that I've seen since I started in business 33 years ago.

Previously a retail location had to collect sales taxes based on the tax rate in the jurisdiction where the outlet is physically located. With "destination sourcing", for shipments outside our local area, we have to collect based on 751 separate taxing jurisdictions.

NFIB members statewide are outraged at the huge new red tape burden imposed on them by this legislation. In spite of the fact that only about 30% of them are directly affected, the outcry from our membership exceeds that of any issue we've faced in at least ten years. In an emergency ballot, our members voted 84% to 11% to work for a revision of the "destination sourcing" provisions.

Here at Midway Wholesale we immediately decided we have no choice but to do our best to comply. We collect hundreds of thousands of dollars of sales tax, and we cannot risk being held accountable for noncompliance.

In May, before "destination sourcing" went into effect, our sales tax report was two pages long, tracked information for six jurisdictions, and required four pages of backup information. For September, our report will be twelve pages long, track information for 159 jurisdictions, and will require more than thirty pages of backup information. Worse, we are collecting far less local tax than previously. We are undoubtedly at risk for tax increases to make up for the lost local revenues.

Presently, Kansas businesses are the guinea pigs, but many other "origin sourcing" states will face the same problem soon if this is not stopped. About 15 states have had "destination sourcing" previously, but none has had anywhere close to 751 taxing jurisdictions-the average in those 15 is about 100. Even at 100, the burden is high, as we know from our many years of doing business in Nebraska, where there are 129.

When the Streamlined Sales Tax Project was started, we were promised "fairness" and "simplification". There is no fairness and the "simplification" is a complete joke.

The SSTP should only be allowed to go forward if it is modified one of the following ways: 1) Require origin-based sourcing only. 2) Allow destination-based sourcing only if a state has a single sales tax rate for out-of-state sellers or at least an option of a single rate for out-of-state sellers.

Furthermore, remote sellers (catalog, internet, telephone, mail order, etc.) with less than $5 million in annual retail sales should be completely exempt from collecting sales taxes for remote states.

Please do not hesitate to contact me if I furnish further information.

Sincerely yours,

Kenneth Daniel
CEO, Midway Wholesale
Chairman, NFIB Kansas
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785-357-7794 (office fax)
kdaniel@midwaywholesale.com

LETTER FROM MICHAEL COPELAND, WITH ENCLOSURE

September 29, 2003

The Honorable Chris Cannon
Chairman, Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
U.S. House of Representatives
B-353 Rayburn HOB
Washington, DC 20015

RE: Oversight Hearing on Streamlined Sales Tax Agreement

Dear Congressman Cannon:

Thank you for the opportunity to submit this letter for your subcommittee hearing on this topic scheduled for October 1. The streamlined sales tax (SST) has become a very important issue in Kansas since conforming legislation was adopted by the Kansas Legislature in 2003.

Kansas cities and counties rely heavily on local sales taxes for financing general government services. The City strongly believes in the ultimate goal of SST legislation-to level the field between local merchants and remote sellers and provide a mechanism to collect state and local sales tax on remote sales. However, our experience since July 1, 2003, the implementation date of the legislation in Kansas, has been difficult for several reasons:

1. Historically, the sales tax in Kansas has been structured around origin-based sourcing. The transition to destination-based sourcing as required by the SST agreement has been confusing to retailers, particularly since the State has a very large number of local taxing jurisdictions.

2. The extension of the State use tax to local units has been a source of concern by some large businesses, although it is critical to the ultimate objective.

3. The implementation date of July 1, 2003 was too early to adequately prepare for a retailer education program and technical support from the State Revenue Department.

The Honorable Chris Cannon
September 29, 2003
Page 2

Our message to the subcommittee is this. Based on our experience, SST changes are painful and take time, but are essential to the ultimate collection of sales taxes due on remote sales. They are designed to respond to court decisions about simplifying the collection of these taxes. Now that SST driven changes are underway nationally, it is imperative that Congress act soon and with certainty to specifically authorize collection of sales taxes on remote sales. Without this authority, the long-term fiscal health of state and local government in the 21st century is at risk.

Also enclosed is a copy of a letter I sent to Representative Doug Mays, Speaker of the Kansas House, on this issue. Best wishes for a successful and informative hearing.

Sincerely,

Michael Copeland
Mayor

Enclosure

pc: Congressman Dennis Moore
Olathe City Council
Frank Taylor, President, Olathe Chamber of Commerce

ENCLOSURE

City of Olathe

August 15, 2003

Representative Doug Mays
Speaker, Kansas House of Representatives
State Capitol Building
Topeka, KS 66612

Dear Representative Mays:

Thank you for conducting a series of town hall meetings on the new streamlined sales tax (SST) legislation passed in the 2003 session. In recent weeks this topic has obviously generated a great deal of interest among legislators, local government, businesses, and the media. The purpose of this letter is to offer some constructive thoughts on this issue, particularly the destination sourcing rule.

The city strongly believes in the ultimate goal of this legislation—to level the field between local merchants and remote sellers and provide a mechanism to collect state and local sales tax on remote sales. However, our immediate concern is the impact of the destination source rule—both its burden on small retailers and the potential revenue loss to our city from major retailers that ship significant volumes of goods elsewhere. Based on a sample of Olathe retailers, we are deeply concerned the negative financial impact of destination sourcing could outweigh any long term gain from the local compensating use tax and from remote sales. We simply don't have adequate information yet to understand consumer and business buying patterns under this new system.

Olathe is a retail trade center, having made a conscious effort for many years to attract major retailers and use sales taxes to reduce our general fund reliance on the property tax. Are we now to be a victim of our success? In the middle of our most difficult budget process in years, we now face a further SST induced erosion of general fund revenues in addition to what the city has already experienced from the downturn in the economy and the loss of $1.75 million in state aid. Yet the service demands remain constant. Mr. Speaker, we need alternatives, not another local sales tax hit!

Some are calling upon you to hold a special session to repeal HB 2005. The city does not believe outright repeal of the SST effort is appropriate; however, we ask that you consider alternatives and improvements that do not jeopardize the ultimate goal:

P.O. Box 768 | Olathe, Kansas 66051-0768 | City Offices: (913) 782-2600 | www.olatheks.org

1. Delay the implementation date to provide time for retailers to adjust and DOR to provide technical assistance.
2. Consider a minimum threshold that would exclude small purchases from destination sourcing and lessen the burden on small business.
3. Study the impact on special sales tax districts like TIF, TDD, and STAR bonds that may have existing sales tax revenue streams already pledged for bonds.
4. Consider excluding intrastate transactions from the SST program.
5. Consider some form of retailer compensation for collection of sales taxes.
6. Delay implementation until Congress has specifically authorized the collection of state and local sales tax from remote sales. It may be years before sales tax on Internet purchases reaches the local level; however our service demands are here today.
7. Consider authority for alternative revenue measures to help local units of government offset losses from implementation of destination sourcing and elimination of state aid. A package of such measures proposed to the 2003 legislature did not receive serious consideration.

On behalf of the entire governing body and the citizens of Olathe, thank you again for the opportunity to bring these ideas forward. We look forward to their consideration by the appropriate body during the interim or the 2004 session.

Sincerely,

Michael Copeland
Mayor of Olathe

LETTER FROM KEN HITE

October 3, 2003

Honorable Chris Cannon
U.S. House of Representatives
Chairman, Subcommittee on Commercial
and Administrative Law
Committee on the Judiciary
B-353 Rayburn House Office Building
Washington, DC 20515

Dear Honorable Cannon:

I would like to share some concerns that are impacting our business, related to the Streamline Sales Tax.

I own Christian Book & Gift Co., with two stores, one in Olathe and one in Topeka Kansas. Though our primary business is with customers who come into the stores, we do ship product daily to customers outside Olathe and Topeka. Much of what we ship is to churches which are tax exempt, but we ship a lot that is taxable.

The purpose of the streamline tax is valid. We are competing more and more with internet sales, and for the most part are losing the competitive edge to internet and out of state companies who do not charge sales tax. Our tax is 7.525%. Needless to say, I am in favor of taxing those sales coming into the state. However, the streamline tax is costing us more than the lost sales.

Our computer system is very complex, thus not just a point of sale system. It incorporates a program to enter and track special orders. At the time of entering the order, every clerk must be able to determine the tax rate. We have towns & cities in Kansas that cross county lines, so part of the city has one county tax and another part in another zone. A mailing address of one city may include rural areas that are not in the city, thus are not taxable at the city rate.
Below are some concerns I expressed to Karin Brownlee, our Kansas State Senator.

1. It is impossible to track without the tax files in our system. At this point, the Kansas Dept. of Revenue says we must use the chart and I guess track it by hand. The chart is inaccurate as it doesn't tell us in which taxing jurisdiction each address is located.
2. Even when they get the downloadable file, then we and every company in the state will have to have software written for the individual computers that are used. This will cost Kansas businesses, millions of dollars. Our computer provider cannot even start working on software until they know the full requirements.
3. If it is zip code based, does that mean rural areas will pay the city sales tax for the zip they are in, or will it be nine-digit zip. If it's nine, I'm not sure our computer will be able to handle the process.
4. Training will be a major issue for our staff, especially the short term and high school students. They will have to be trained to determine the tax jurisdiction at the time of the order or at the time of purchase. Their error could cost me in the event of an audit.
5. Another area of concern is the paperwork involved in submitting the form. We will have to list every city and tax jurisdiction to which we mail. This will be a manual job as our computer system will not print the required form.

At this time, Kansas isn't enforcing the law and we are doing the best we can by tracking by hand. At the point that enforcement is put in place, we will be forced to end our service of shipping to areas outside of our own cities.

I would strongly encourage congress to consider a plan where each state has one statewide tax for merchandise shipped into or within the state. Each state could then determine how that tax would be distributed. We would only have 50 tax rates to track at that point.

This complex issue does need to be resolved. Out of state companies shouldn't be excluded from the sales tax, but the system must be simple enough to be manageable by both large and small companies.

Thank you for the opportunity to share my thoughts and concerns.

Sincerely

Ken Hite
CEO

LETTER FROM STAN CLARK

40TH DISTRICT

KANSAS SENATE

Stan Clark

COMMITTEE ASSIGNMENTS
CHAIR: UTILITIES
MEMBER: ASSESSMENT & TAXATION
ELECTIONS & LOCAL GOVERNMENT
ORGANIZATIONS, CALENDAR, & RULES
RULES & REGULATIONS

September 29, 2003

Rep. F. James Sensenbrenner, Chairman
Judiciary Committee, U. S. House of Representatives
B-353 Rayburn HOB
Washington, DC 20015

Chairman Sensenbrenner and members of the Committee,

I am Stan Clark, member of the Kansas Senate for the past 9 years and the owner of a small photography studio for the past 28 years. This past week Diane Taylor, Counsel for your committee, contacted me about my experience in adopting the Stream-lined Sales Tax Project in Kansas.

Kansas has over 750 sales tax jurisdictions, the small community where I live (Oakley) has a population of 2000 but the city limits is located in three counties and the post office delivers mail to four counties. Until July of this year all sales to Kansas citizens were charged sales tax based on the location of my business and all out-of-state sales were sales tax exempt.

When I take pictures of the local High School track team, the running events are in Logan County and the field events are in Thomas County. When I take pictures at the local High school alumni reunion I can have several hundred people order pictures that evening, and I am now supposed to charge sales tax based on where the person lives because I mail their class picture. All of these orders vary from $6.00 to $10.00 and the local sales tax amount is never more than 25 cents. Now I am suppose to check each person's address, verify the amount of sales tax and record the amount due in each of the possible 753 sales tax jurisdictions monthly. If you pass authorization to allow destination sourcing nationwide I will be required to collect sales tax for every sales tax jurisdiction nationwide. The potential exists that I will have to write countless checks for less than $5.00 monthly or authorize an electronic funds transfer in similar amounts to a number of

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1-800-432-3974

states. A common example would be photographs at a wedding. Most of the time 10 to 12 people (family members and members of the bridal party) order 2 to 5 pictures. The retail sales would be from $10 to $100 and it is likely that the orders are from 3 or 4 states. No one, even with a demented mind, can claim that this is sales tax simplification.

When I take pictures at a wedding I charge for the time that I am at a wedding. I asked the department what jurisdiction I would use to charge for the time at the ceremony and reception when they are located in multiple sales tax jurisdictions? The reply came back that I was to charge based on the jurisdiction that the newlyweds first make their home. I protested because many times I don't know that until they place their order 6 weeks or more after the wedding. The Department changed their ruling and now the sales tax is charged to where the bride's parents live which I usually know.

If I was to die today, the local mortician in charge of the service lives and has his business in Logan County, the church where I am a member is in Gove County and the cemetery is in Thomas County, all within a few miles of each other. What local sales tax jurisdiction for the casket? Memory cards? Hearse? Flowers? Limo for pallbearers? At first the Kansas Dept. of Revenue ruled that the jurisdiction was where any item was first used, later they decided all services would be based on the location of the funeral home.

Sales tax should be based on the location of the business not on the location where the purchaser first receives possession of the product or service. As policy makers we should encourage businesses to locate within our districts to provide employment, increase the property tax base, and strengthen our communities. One reward should be that the sales tax collected will remain in the city, county and state where it is collected.

When I voted for SB 192 which eventually became HB 2005 I had an explanation recorded on both votes. The Chairman of the Senate Assessment and Taxation Committee assured me that all businesses with less than $5 million annual sales would be exempt from this legislation and without this assurance the legislation would place an undue compliance burden on these businesses. A copy from the Journal follows.

SB 192, An act concerning sales taxation; enacting the streamlined sales and use tax agreement conformity act; local sales tax transportation development district act; amending K.S.A. 12-189a, 12-191, 12-198, 75-5151, 79-3607, 79-3608 and 79-3651 and K.S.A. 2002 Supp. 12-194, 25-432, 79-3602, 79-3603, 79-3606, 79-3650 and 79-3703 and repealing the existing sections; also repealing K.S.A. 12-191a, 12-17,130, 12-17,131, 12-17,132, 12-17,133, 12-17,134, 12-17,135, 12-17,136, 12-17,137, 12-17,138 and 12-17,139.

On roll call, the vote was: Yeas 34, Nays 5, Present and Passing 0, Absent or Not Voting 1.

Yeas: Adkins, Allen, Barnett, Barone, Brownlee, Brungardt, Buhler, Bunten, Clark, Corbin, Donovan, Downey, Emler, Feleciano, Gilstrap, Gooch, Goodwin, Haley, Harrington, Hensley, Jackson, Kerr, Lee, Morris, Oleen, Salmans, Schmidt, Schodorf, Steineger, Taddiken,

Teichman, Umbarger, Vratil, Wagle.
Nays: Huelskamp, Lyon, O'Connor, Pugh, Tyson.
Absent or Not Voting: Jordan.
The bill passed, as amended.
EXPLANATION OF VOTE
MR. VICE PRESIDENT: I vote yes on **SB 192**. This vote is with the understanding and assurance from the Senate Assessment and Taxation Chairman that an anticipated minimum gross sales threshold of $5 million will be adopted before the January 1, 2006 effective date of this act. Without this assurance, this act places an undue compliance burden on beginning small retail businesses in our state.—STAN CLARK
Senators Harrington and Tyson request the record to show they concur with the ''Explanation of Vote'' offered by Senator Clark on **SB 192**..

I would recommend the following:

- Seek to overturn the Quill decision because regardless of where I purchase a product, any sales tax collected should remain where the business is located.
- If you cannot find a constitutional way to accomplish the first item then exempt all businesses with less than $5 million in annual retail sales.
- If the second item cannot be accomplished, table the issue. The idea isn't ripe for implementation. The compliance costs are too great and who really is going to audit businesses for compliance? The amounts are too minimal except for a handful of catalog and internet businesses that the potential recovery of sales tax dollars for the state do not justify the audit costs and no city or county is equipped to audit businesses nationwide and the business community should not be subject to random harassment from them.

I will be glad to respond to any questions and you are welcome to phone me at 785-672-4280 or email me at sclark@ink.org.

Sincerely,

Stan Clark

Stan Clark

LETTER FROM THE SOCIETY OF AMERICAN FLORISTS

SAF
SOCIETY of AMERICAN FLORISTS

1601 Duke Street
Alexandria, VA 22314
USA
703.836.8700 voice
703.836.8705 fax
www.safnow.org
www.aboutflowers.com

October 7, 2003

The Honorable Chris Cannon
Chairman, Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
B 353 Rayburn House Office Building
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Cannon,

The Society of American Florists (SAF), FTD Inc. and Teleflora Inc. want to express our strong support for the small business exemption of $5 million that is included in H.R. 3184, the "Streamlined Sales and Use Tax Act." The bill, introduced on September 25 by Rep. Ernest Istook (R-OK) and Rep. William Delahunt (D-MA), endorses the provisions of the Streamlined Sales Tax Project (SSTP) Agreement and promotes simplification and fairness in the administration and collection of sales and use taxes.

The floral industry has been working diligently over the last 18 months to support retail florists by attending many SSTP meetings and relaying specific concerns about certain provisions of the agreement to SSTP officials. Retail florists are one of the few small business segments that will incur a significant challenge from the SSTP due to the way in which wire service orders that are sent between florists all over the United States will be taxed. The easiest solution to that challenge is to have a small business exemption, like the one included in H.R. 3184. This would exempt companies with less than $5 million in gross remote taxable annual sales from the burdensome recordkeeping required to collect and remit sales tax on the destination of wire orders.

SAF, FTD and Teleflora fully support a $5 million exemption, but at the same time we would ask that Congress consider increasing the exemption to $10 million. This amount would free nearly all retail florists in the United States from the difficulties inherent in having to know literally hundreds of tax rates for different states and municipalities, making the administration and collection of taxes much more complex for retail florists. Another option we ask you to consider is to index the exemption amount. This also would help retail florists in the years to come.

SAF is the national trade association representing the entire U.S. floral industry, a $19 billion component of the U.S. economy. SAF represents all segments of the floral industry including retailers, growers, wholesalers, wire services, importers,

Page Two
October 7, 2003

suppliers, educators and related organizations. Our membership includes nearly 14,000 small businesses located in every congressional district in the country.

FTD and Teleflora are the two dominant wire services in the floral industry. A wire service clears the orders that are sent from one florist to another, a process that makes it easy for consumers to send flowers to friends and loved ones. Collectively, Teleflora and FTD serve more than 30,000 retail florists nationwide.

We appreciate your willingness to listen to our concerns and we hope you and your colleagues will consider our comments as discussion on SSTP and H.R. 3184 moves forward. Working through The Society of American Florists headquartered in Alexandria, Virginia, representatives from the industry would be happy to help you in any other way, including testifying on this issue, if necessary.

Sincerely,

Peter Moran
EVP/CEO
Society of American Florists

Robert Norton
President
FTD, Inc.

Tom Butler, AAF
Chairman
Teleflora, Inc.

cc: Members of the Subcommittee on Commercial and Administrative Law

PREPARED STATEMENT OF THE INTERNATIONAL COUNCIL OF SHOPPING CENTERS

ICSC is the global trade association of the shopping center industry. Its more than 43,000 members in the United States, Canada and 77 other countries around the world include shopping center owners, developers, managers, investors, lenders, retailers and other professionals. **The shopping center industry contributes significantly to the U.S. economy. In 2002, shopping centers in the U.S. accounted for over $1.2 trillion in retail sales and over $53 billion in state sales tax revenues and employed almost 11 million people.** ICSC is a founding member of the e-Fairness Coalition, a diverse group of brick-and-mortar and online retailers and trade associations that support a level playing field with regard to sales and use tax collection.

We strongly support the *Streamlined Sales and Use Tax Agreement*, as well as the *Streamlined Sales and Use Tax Act* (H.R. 3184) recently introduced by Representatives Ernest Istook (R-OK) and William Delahunt (D-MA), and appreciate this opportunity to submit our testimony to this Subcommittee. We believe that addressing remote sales tax collection separately from the Internet access tax moratorium will provide tremendous clarity to the debate, and we thank you for addressing this issue.

The *Streamlined Sales and Use Tax Agreement* (SSUTA) is a **voluntary** multistate agreement that outlines a comprehensive system to streamline, simplify and collect our nation's various sales and use taxes. **Such simplification measures include uniform sourcing, definitions, registration, central administration (and limits to changes) of state and local rates, exemptions, seller compensation, remittance and amnesty rules.** The SSUTA is the product of years of negotiations between various business and governmental groups including the National Conference of State Legislatures, National Governors Association, U.S. Conference of Mayors and the National Association of Counties.

The SSUTA takes effect when at least ten states representing at least twenty-percent of the population have been certified compliant with the terms of the Agreement. While twenty states, including Texas, Ohio, North Carolina, Washington, Indiana and Utah, have so far enacted conforming legislation within their own states, it is unclear whether the threshold has been actually met (due to effective dates and other provisions within several states' bills).

While the SSUTA provides a blueprint for states to create a simplified sales and use system, it remains a voluntary system for out-of-state retailers. Remote sellers may benefit from the system (e.g., amnesty provisions) and decide to enter into it, however, they cannot be compelled to participate in the program and collect remote sales and use taxes. **Only Congress has the authority to allow states to require out-of-state merchants to collect sales and use taxes on their behalf.** If such authority is granted, only those states that have sales and use taxes and want to exercise their collection authority can do so.

Contrary to what some have said, it is not the existing moratorium on Internet access taxes and new, multiple or discriminatory taxes on electronic commerce that precludes states from requiring out-of-state retailers to collect sales and use taxes. Instead, it is a 1992 Supreme Court case, *Quill* v. *North Dakota*, that held that remote merchants are not required to collect sales and use taxes for states in which they do not have a physical presence or "nexus". However, **the Court clearly recognized Congress' authority to enact legislation that would allow state and local governments to require out-of-state retailers to collect sales and use taxes on their behalf (even in the absence of a traditional "nexus").**

H.R. 3184, if enacted, would *allow* those states that comply with the simplification provisions of the SSUTA to require remote sellers to collect sales and use taxes on their behalf. It provides for reasonable seller compensation and proper governance of the SSUTA. **H.R. 3184 applies only to sales and use taxes, and would not subject retailers to other out-of-state taxes such as franchise, business activity and income taxes.**

In addition, it contains a small business exemption whereby businesses with annual remote sales of less than $5 million would not be required to collect remote sales taxes. **ICSC believes the $5 million small business threshold is appropriate and should not be lowered during the legislative process.**

Rationale:

Simply stated, we believe that *all* goods, regardless if they are purchased over the Internet, via catalog or in traditional retail stores, should be subject to the same state and local tax collection requirements. **One form of commerce should not receive preferential tax treatment over another.** Unfortunately, existing tax law is structured to favor electronic commerce over sales made in local retail stores.

The following point cannot be overstated: **The taxes which states should be able to require remote sellers to collect are *not* new taxes. Instead, they are *existing use* taxes which buyers are currently obligated to remit to their state and local governments.** [Sales taxes are generally paid and collected by the retailer at the place of purchase, while use taxes are supposed to be paid by a buyer to his or her state of residence on an out-of-state item that is brought or mailed to his or her home.]

As a practical matter, however, most individuals are either unaware of their use tax obligations, or simply do not bother to comply, and it is very difficult for states to enforce collection by their residents. Although some states have added a "use tax" line to its individual income tax returns, most taxpayers in these states remit just a small portion of what is legally owed. **Unless an out-of-state merchant has a store or warehouse in a buyer's home state, most consumers only remit use taxes to their home state when they purchase an item out-of-state that has to be registered in-state, such as an automobile or boat.**

We support electronic commerce and believe it should be fostered. In fact, many traditional brick-and-mortar retailers have incorporated e-commerce into their business models in order to obtain new customers and better serve existing ones. However, as a matter of fairness and sound tax policy, Internet-based retailers should not receive a competitive tax advantage over traditional brick-and-mortar merchants simply because electronic commerce is a newer and growing form of transacting business.

The reality is, as more and more Americans go online to purchase goods, the competitive tax advantage that Internet-based retailers currently enjoy will continue to negatively affect many local brick-and-mortar retailers, shopping centers and their communities. Not only will traditional retailers sell fewer goods, but their employees will suffer from reduced working hours, wages or layoffs.

In addition, many state and local governments are experiencing budget deficits, including significant drops in sales tax revenues—revenues that provide essential public services such as education, police and fire protection, and road repairs. ***Governments that rely heavily on sales tax revenues to fund key programs will either have to increase taxes (including sales, property and/or income taxes) or reduce or eliminate key services.*** If governments decide to increase sales tax rates to make up for lost revenues, lower-income individuals would wind up paying an even higher share of their income on sales taxes since they are less likely to own computers and purchase products on-line.

Our critics assert that electronic commerce is a new and growing industry and, therefore, should not be saddled with "old world" sales tax collection requirements. Our response is that, while electronic commerce is a growing and important part of our economy, subjecting it to the same sales tax collection requirements that traditional merchants have been subject to for decades would not harm its growth or vitality. **Electronic commerce will continue to flourish, regardless of whether or not sales and use taxes are collected by remote retailers.**

These critics also claim that forcing Internet retailers to collect sales and use taxes for the thousands of state and local taxing jurisdictions across the country would be too burdensome on electronic commerce and cannot be done. We agree that all businesses, especially small businesses, should not be overburdened by sales tax collection requirements.

However, under H.R. 3184, states would have to comply with the simplification provisions of the SSUTA before they could require remote retailers to collect sales taxes. In addition, such retailers would be given reasonable compensation for their collection efforts, as well as access to certified tax collection software. Also, as stated earlier, the bill provides an exemption for businesses with annual remote sales of less than $5 million.

In conclusion, ICSC supports the SSUTA and urges Congress to enact H.R. 3184 in order to level the playing field between Internet-based and traditional brick-and-mortar retailers. Thank you for this opportunity to express our views on this very important matter.

PREPARED STATEMENT OF THE NATIONAL GOVERNORS ASSOCIATION

The National Governors Association supports H.R. 3184, the Streamlined Sales and Use Tax Act (SSUTA), introduced by Representatives Istook and Delahunt to enable states to implement a more equitable and simplified sales and use tax system.

We are encouraged by the progress state and local governments and the business community have made to streamline America's current state and local sales and use tax laws and combine them into a simple, uniform collection and administration system. Thirty-eight states have joined together to approve the Streamline Sales and Use Tax Agreement, a model interstate agreement that establishes uniform definitions for taxable goods and requires participating states and local governments to have only one statewide tax rate for each type of product. Over the past year 20 states, representing over thirty percent of the population, have passed legislation to bring their sales tax laws into conformity with the agreement, and more are expected by the end of the year.

This effort was necessary to restore fairness to competition between local retail store purchases and out-of-state mail transactions and to provide a means for states to collect taxes that are owed under existing law. The SSUTA will allow states to implement a twenty-first century sales tax system that can achieve fairness for all forms of sales: Main Street, mail order, and Internet. Congress should recognize the work of the states and approve the Simplified Sales and Use Tax Act as a means of securing equitable collection of sales and use taxes and ensuring that states are prepared to support the global electronic marketplace.

Let us be very clear on one point: the SSUTA is not a new tax, tax increase, or a tax on the Internet. Every state that levies sales taxes requires a use tax to be paid if a customer's purchase is made online or out of state. Under current legal standards, a state may only impose sales and use tax collection requirements on sellers with a physical presence, or nexus, in the state whether the transaction is over the Internet or not. As a result, remote sellers are able to compete for customers in a state—whether by mail, telephone, or the Internet—without being required to collect or remit tax on their sales into the state. Competitors that are physically present in the state are required to collect and remit the tax. The resulting inequity will only continue to grow as the digital economy expands.

The streamline effort has the support of brick-and-mortar and online retailers; retail and real estate associations; publicly- and privately-owned shopping centers; state and local government groups; and organizations representing firefighters, teachers, police and other public sector workers. Congress should recognize the extraordinary work by states to streamline and modernize America's sales tax system and restore fairness to Main Street businesses by passing the Streamline Sales and Use Tax Act.

PREPARED STATEMENT OF CHARLES COLLINS

Velosant

Statement for the Record to the House Judiciary Subcommittee on Commercial and Administrative Law

regarding

Sales Tax Simplification Legislation

October 2003

Charles Collins
Director Government Affairs

CHARLES D. COLLINS Jr.
STATEMENT FOR THE RECORD TO THE HOUSE JUDICIARY SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

I. Statement

INTRODUCTION

I am Charles Collins, and I am Director of Government Affairs with Velosant, previously known as Taxware. Prior to joining Taxware, I was employed by the North Carolina Department of Revenue for thirty-two years and spent my last ten years as Director of the Sales and Use Tax Division. I have worked on a number of efforts to simplify the administration of sales tax and have worked on the Streamlined Sales Tax Project as a government delegate, Project Co-Chair and as a business representative. I am providing this written testimony to address sales tax simplification, with specific attention to the application of sales tax technology in the simplification debate.

Sales tax technology has been in existence for over twenty years, and is applied successfully by thousands of merchants in every industry. This technology determines the taxing location in multistate transactions through use of the mailing addresses of the merchant and its customer. Exemption databases are searched in transactions involving specially treated products, services, entities or uses. The applicable state and local tax rates are applied, the transaction is recorded, and tax liability information is inserted to the correct space on the applicable tax return.

My company has been advising taxing authorities on the use of sales tax technology since 1998. We have met with numerous state and local governmental agencies and associations over the past five years, in an ongoing effort to demonstrate the capabilities of tax technology. Jon Abolins, our Vice President, testified before this subcommittee in 2001. Our efforts contributed to the technology models proposed by the Streamlined Sales Tax Project and the National Conference of State Legislatures, and we participated in a feasibility study of these technology models. Our activities include the modification of our existing, widely used tax technology to accommodate sales tax simplification efforts, while concurrently ensuring the protection of consumer privacy. We feel that our participation in the feasibility study (pilot project) successfully proved the concept and the proposed technology models are indeed feasible.

RECOMMENDATIONS

Velosant does not assert that software and technology alone, without significant reform of state sales tax laws, will achieve the levels of simplification and accuracy sought by the private or public sectors. The lack of uniform standards for tax technology forces every business to develop a customized sales tax compliance system, even if third party tax calculation software is applied. The lack of timely tax information from government sources, the continued need to obtain valid paper exemption certificates from customers and the need to fill out hundreds of local tax returns each month represent tremendous operating costs for any merchant doing business in many states. To ensure the success of sales tax simplification, four major issues must be addressed:

- First, there must be unified administration of state and local taxes. Merchants and tax technology providers should be able to obtain all necessary information from one statewide state taxing authority. This will eliminate the need to seek out ordinances and other tax information from local taxing authorities, a sometimes impossible task. State taxing authorities must be required to provide notification of law or rule changes within sufficient time for implementation into a computer system, and those reliant upon such information should be held harmless if that information is not provided

- Second, state taxing authorities must work together to create uniform definitions for specially taxed products and services. The harmonization of existing tax bases through implementation of common definitions is a viable alternative to restricting those tax bases

- Third, state taxing authorities should simplify exemption procedures, eliminating current exemption certificate requirements. Today, merchants must obtain and maintain paper exemption certificates as evidence of tax-free transactions with churches, charities, and other exempt purchasers. Failure to comply with this rule can result in significant liability to the merchant. Purchasers claiming they are exempt from sales tax should be the party required to prove that the product or service purchased was actually used for an exempt purpose; merchants should be held harmless for granting an exemption as long as they retain sufficient information to identify the purchaser and the product or service purchased

- Fourth, state taxing authorities must adopt uniform rules for reporting and remitting sales tax liabilities. Tax returns should only be filed with state taxing authorities. A nationwide standard for the format of a tax return is essential to simplification efforts

After these four issues are resolved, merchants will be able to set up tax technology quickly, and customers of merchants using tax technology will notice no difference in their shopping experiences. It is important to note that the model simplification statutes currently embodied in the Streamlined Sales Tax Agreement and already approved by at least 17 states include provisions that satisfy these four issues, as well as the required technology components.

Some alternative simplification proposals include a requirement that each state enact only one rate, eliminating local authority to enact the tax rate and base best suited to residents of that community. This is an unnecessary simplification, as tax technology easily handles local tax rates. Following the example set by the Mobile Telecommunications Sourcing Act, state taxing authorities are proposing to provide databases of all mailing addresses within their taxing jurisdictions, and will hold merchants applying these databases to assign tax rates harmless from liability for inaccuracies. Once these databases are made available, our technology and that of others will be able to assign many tax rates to a mailing address on a cost effective basis.

CHARLES D. COLLINS Jr.
STATEMENT FOR THE RECORD TO THE HOUSE JUDICIARY SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

The Streamlined Sales Tax Agreement contains simplifications that render sales tax schemes manageable and economically feasible. Provisions in the agreement provide for compensation for tax technology providers for the creation and maintenance of sales tax systems directly. The implementation of tax technology can be performed at no cost to merchants. The simplification provisions in the Agreement, coupled with the elimination of tax technology implementation costs to merchants, can achieve sufficient sales tax simplification.

Whenever tax technology is addressed in the context of sales tax simplification, questions regarding the implementation of tax technology into the operations of a "mom & pop merchant" are always raised. The de minimis standards proposed in most sales tax simplification legislation will obviate the need for such merchants to use tax technology. It should be noted that thousands of small merchants making remote sales apply tax technology today. Sales tax calculations are a standard component of the software that Internet retailers have applied for years in the states where they are currently required to collect tax.

Lastly, the issue of privacy of consumers has been addressed in the Agreement. Purchase information is not accumulated except for that information necessary to facilitate the purchase, as it is in purchases today. Companies such as ours are not permitted to retain any personally identifiable information on the purchaser, except in cases of purchasers claiming an exemption. If a purchaser is claiming a tax exemption, the purchaser will be required to provide name, address, reason for exemption and products purchased consistent with current practice. This information is needed so the seller can provide the information to the appropriate government jurisdiction to ensure the validity of the transaction. For purchases where tax is collected at the general rate it is only necessary to obtain zip plus 4-address information which sellers obtain anyway for delivery or credit card verification purposes, so the seller and government authority can accurately distribute the tax. In both situations this is the case with purchases today.

In summary I think there are three important questions to focus on:

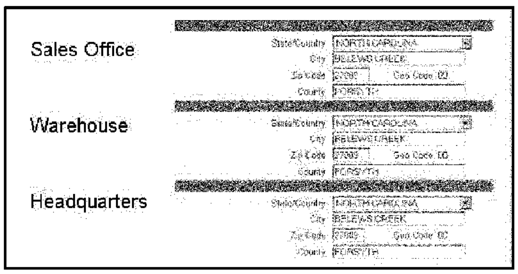
- Can software calculate sales tax on remote transactions? Yes. It provides this function today and with the simplifications proposed, it will perform these functions to a degree that is much more cost effective and accurate.
- Who is responsible for funding the development of software? The states. The Agreement contains provisions calling for the states to reimburse software providers for the cost of installing tax calculation software for remote merchants.
- Who is responsible if there is an error in collection? The states. The Agreement contains provisions holding the merchant harmless for errors in collection when the state provided information is used.

I appreciate the opportunity to present the views of my company on this important issue of public policy. We welcome future opportunities to discuss and demonstrate sales and use tax technology in greater detail.

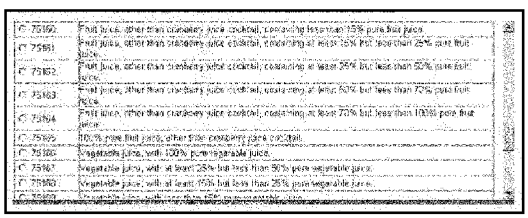
II. Sales and Use Tax Technology in Action

Sales and use tax calculation software has been on the market for over twenty years, and has been applied successfully by thousands of merchants across the United States. Although some features of the technology will be unnecessary after tax simplification, the fundamental structures and processes of the system will remain the same.

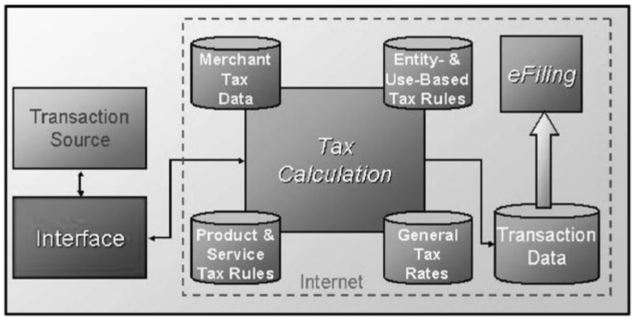
Merchant Tax Data Files allow vendors to implement their use tax collection obligation by turning off taxing jurisdictions in which they have no physical presence. Merchants also input their business locations into the system, and associate their product- or service-lines with exempt product and service codes. Merchant Exemption Files allow vendors to implement exemptions based upon receipt of a direct pay or exemption certificate.



During the tax calculation process, the vendor and customer mailing addresses are compared to determine the taxing location, and the type of tax (i.e., sales or use). Exemptions are sought in the Tax Rate File, the Product Taxability File and Merchant Exemption Files; tax calculation systems have the ability to implement both product-based exemptions, and entity- and use-based exemptions.



After transactions are calculated, the results are sent to billing applications and eCommerce billing solutions for entry onto the transaction document (i.e., invoice), and are concurrently stored in an Audit File. Automated tax return software places summary data from the audit file onto the appropriate space on the applicable tax return.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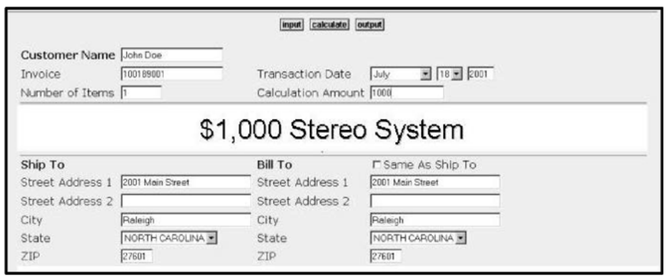
Entity- & Use-Based Tax Rules
eFiling
Transaction Source
Tax Calculation
Interface
Product & Service Tax Rules
General Tax Rates
Transaction Data
Internet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Calculation Amount
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Bill To
Same As Ship To
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Street Address 2
City
Raleigh
State
NORTH CAROLINA
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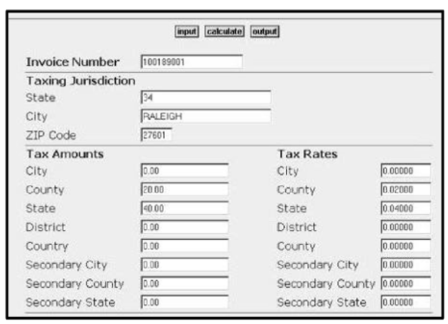
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Country 0.00
Secondary City 0.00
Secondary County 0.00
Secondary State 0.00
Tax Rates
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County 0.02000
State 0.04000
District 0.00000
County 0.00000
Secondary City 0.00000
Secondary County 0.00000
Secondary State 0.00000

III. The Streamlined Sales Tax Agreement Proposed Technology Models

Over seventeen states have to date enacted legislation that will lead to the certification of the sales and use tax calculation software merchants use to determine tax liabilities. The Streamlined Sales Tax Agreement provisions include the creation of three certified technology models.

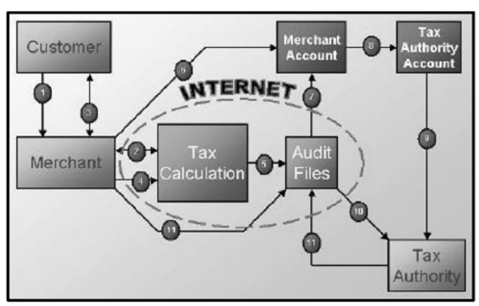
Model 1 – The Certified Service Provider

The Streamlined Sales Tax Agreement "Model 1" technology is defined as a system through which a "[s]eller selects a Certified Service Provider (CSP) as an agent to perform all the seller's sales or use tax functions, other than the seller's obligation to remit tax on its own purchases." The CSP will use technology to calculate, report and remit the tax liabilities for all transactions of all merchants using its service. Merchants licensing CSP services will be relieved of liability for any incorrect tax calculations, reports, and remittances, unless merchant fraud is found. They will also avoid audit liability on transactions processed through the software. The CSP will be liable to taxing authorities for any incorrect tax calculations produced by the software. Taxing authorities will compensate CSPs for the performance of CSP services; the technology to be applied by merchants, including the integration of merchants' existing systems to CSP systems, will be offered to merchants at no charge.

Tax liabilities on the transactions of merchants using a CSP will be ascertained, reported and remitted in an eleven-step, automated process:

1. A customer selects products or services, and places a sales order with the merchant. The customer or order entry clerk enters all required information.

2. The tax calculation software determines the applicable tax liability and sends the calculation results to the merchant's system for presentment to the customer or placement on an invoice.



3. The customer or order entry clerk finalizes the transaction after tax liability is displayed.

4. The final tax liability is calculated. This could happen weeks after the placement of the sales order, as many merchants accept sales orders for products that are on back order.

5. The tax information related to the transaction is stored in Audit Files.

6. The tax paid by the customer to the merchant is deposited into the merchant's account using existing practices.

7. The Audit Files are used to determine how much tax is due from the merchant to all applicable taxing authorities.

8. The information learned in step 7 is used to transfer funds from the merchant's account to all applicable taxing authority accounts. The transfer is performed using standard ACH Credit or Debit, or EFT Credit or Debit protocols.

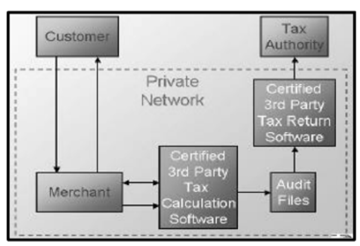
9. The taxing authority receives a statement from their bank reflecting all deposits into the taxing authority account.

10. The CSP transmits a periodic tax return for each merchant using the service.

11. The taxing authority or merchant can use an Internet browser to review information in the Audit Files. Information can be downloaded or printed.

The Model 1 technology was used in practice for the first time in mid-2001. Four states, Kansas, Michigan, North Carolina and Wisconsin, were enabled by their state governments to participate in a Streamlined Sales Tax Pilot System. The state of North Carolina issued a Request for Proposals for the creation of Model 1 technology in June 2000, and awarded two contracts to TAXWARE International in August 2000. The system was provided to a remote vendor and tax was collected through the system for remote transactions. The pilot project provided states governments the opportunity to work cooperatively in tax collection and with a third party vendor to determine the linkage between them and such a system. The Pilot System provided proof of concept for Model 1 and showed that the model is technically and economically feasible.

Model 2 – Certified Automated Software

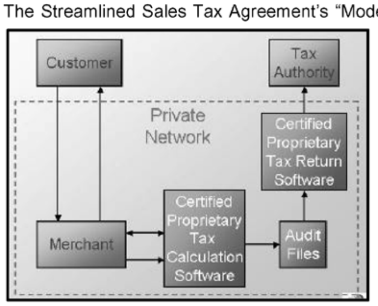


Many merchants do not favor Model 1 technology, fearing it could potentially slow transactions. Other merchants do not want their transactions processed outside of their internal computer security systems. The Streamlined Sales Tax Agreement created a separate technology model to avoid these issues. "Model 2" technology is defined as a system through which a "[s]eller selects a Certified Automated System (CAS) to use which calculates the amount of tax due on a transaction."

The CAS is a certified software application that is installed inside of a merchant's private computer network. Merchants using a CAS will be relieved of liability for transactions incorrectly calculated by the software, but they will remain liable for reporting and remitting transaction tax obligations to the applicable taxing authorities. Merchants will license CAS directly from the third party creators of the software. The Streamlined Agreement contains provisions compensating a taxpayer for acquiring a CAS.

Model 3 – The Certified Proprietary System

The Streamlined Sales Tax Agreement's "Model 3" technology is defined as a system through which a "[s]eller utilizes its own proprietary automated sales tax system that has been certified as a CAS." This technology model was created to allow those merchants that have created their own tax calculation systems to enjoy some elements of certification. The level of certification will vary according to the features of the merchants' proprietary systems.



CHARLES D. COLLINS Jr.
STATEMENT FOR THE RECORD TO THE HOUSE JUDICIARY SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

IV. Biography – Charles Collins

Charles Collins is Director of Government Affairs for Velosant, formerly known as Taxware. In this role he is responsible for sustaining Velosant's relationship with governmental and tax authorities worldwide. Prior to joining Velosant, Mr. Collins was employed by the North Carolina Department of Revenue for thirty-two years where he had a number of positions including the last ten as Director of the Sales and Use Tax Division. He has worked on numerous efforts to simplify sales tax compliance. He was Co-Chair of the Streamlined Sales Tax Project for two and on half years and has authored a number of articles. He is a frequent speaker on State and Local tax matters including sales tax simplification and the use of technology in tax administration. Mr. Collins is a graduate of North Carolina State University with a degree in Economics and holds a masters degree in Business Administration from the University of North Carolina at Greensboro.